



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BUILDING
400 NORTH STREET, HARRISBURG, PA 17120

BUREAU OF
INVESTIGATION
&
ENFORCEMENT

January 7, 2020

Via Electronic Filing

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Pennsylvania Public Utility Commission v.
Twin Lakes Utilities, Inc.
Docket No. R-2019-3010958
I&E Main Brief

Dear Secretary Chiavetta,

Enclosed please find the Bureau of Investigation and Enforcement's (I&E) **Main Brief** in the above-captioned proceeding.

Copies are being served on active parties of record as evidenced in the attached Certificate of Service. Should you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Erika L. McLain". The signature is fluid and cursive, with a long horizontal line extending to the right.

Erika L. McLain

Prosecutor
Bureau of Investigation & Enforcement
PA Attorney ID No. 320526
(717) 783-6170
ermclain@pa.gov

ELM/ac
Enclosure

cc: Honorable Marta Guhl (*ALJ, PUC Philadelphia*)
Per Certificate of Service

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3010958
	:	
Twin Lakes Utilities, Inc.	:	

**MAIN BRIEF
OF THE
BUREAU OF INVESTIGATION AND ENFORCEMENT**

Erika L. McLain
Prosecutor
PA Attorney ID No. 320526

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, Pennsylvania 17120

Dated: January 7, 2020

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I. INTRODUCTION

A. History of the Proceeding

On July 23, 2019, Twin Lakes Utilities, Inc. (“Twin Lakes” or “Company”) filed Supplement No. 8 to Tariff Water-Pa. P.U.C. No. 4 (“Supplement No. 8”) to become effective September 19, 2019. Supplement No. 8 contained rates, rules, and regulations designed to increase the Company’s distribution rates by approximately \$211,793. The requested revenue increase equates to an approximate 158.63% increase over existing distribution rates.

Pursuant to 66 Pa. C.S. § 1308(d), on August 29, 2019, the Pennsylvania Public Utility Commission (“PUC” or “Commission”) suspended the filing by operation of law and assigned it to the Office of Administrative Law Judge (“OALJ”) for the development of an evidentiary record and Recommended Decision. The Bureau of Investigation and Enforcement (“I&E”) filed its Notice of Appearance on July 29, 2019. The case was assigned to Administrative Law Judge Marta Guhl (“ALJ” or “ALJ Guhl”), who conducted a prehearing conference on September 23, 2019. In addition to the Commission’s Bureau of Investigation and Enforcement and the Company, the Office of Consumer Advocate (“OCA”) also actively participated in the case.

Two public input hearings were held in Shohola, Pennsylvania on October 17, 2019. Pursuant to the procedural schedule agreed to at the prehearing conference, the parties exchanged direct, rebuttal, and surrebuttal testimony. I&E introduced the

following statements of testimony and exhibits:

- I&E Statement No. 1, I&E Exhibit No. 1, and I&E Statement No. 1-SR, the prepared direct and surrebuttal testimony and exhibit of John Zalesky;
- I&E Statement No. 2, I&E Exhibit No. 2, I&E Statement No. 2-SR, and I&E Exhibit No. 2-SR, the prepared direct and surrebuttal testimony and exhibits of Christopher M. Henkel;
- I&E Statement No. 3, I&E Exhibit No. 3, and I&E Statement No. 3-SR, the prepared direct and surrebuttal testimony and exhibit of Esysan A. Sakaya.

Cross-examination was waived by the parties and evidentiary hearings were cancelled by ALJ Guhl. The Parties sought to enter their respective testimony and exhibits into the record through a Motion and Stipulation filed on December 17, 2019. ALJ Guhl issued an Order on December 18, 2019 granting the Motion and Stipulation. On December 19, 2019, I&E filed its testimony and exhibits along with witness verifications with the Commission's Secretary's Bureau. I&E now files this main brief pursuant to the procedural schedule established in this case.

B. Burden of Proof

In any proceeding upon the Commission's motion involving a public utility's proposed rate or in any proceeding upon complaint involving a proposed rate increase, the burden to show that the proposed rate is just and reasonable falls squarely upon the utility.¹ Moreover, it is well-established that the utility must produce substantial evidence

¹ 66 Pa. C.S. § 315(a); *Irwin A. Popowsky v. Pa. P.U.C.*, 674 A.2d 1149 (Pa. Cmwlth. 1996).

to satisfy its burden.² Substantial evidence is “that quantum of evidence which a reasonable mind might accept as adequate to support a conclusion.”³

In base rate cases, the Commission has affirmed the utility’s burden of proof and clearly indicated that the burden of proof never shifts to the party challenging a requested rate increase.⁴ While the burden of going forward may shift, the burden of finally and convincingly establishing the justness and reasonableness of every component of a requested rate increase remains on the utility:

[t]here is no presumption of reasonableness which attached to a utility’s claim, at least none which survives the raising of credible issues regarding a utility’s claim. A utility’s burden is to affirmatively establish the reasonableness of its claim. It is not the burden of another party to disprove the reasonableness of a utility’s claims.⁵

Thus, Twin Lakes is under the obligation to affirmatively prove the reasonableness of each element of each of its claims. Pursuant to Section 315(a) of the Public Utility Code, the burden of proof for all claims remains on the Company and the proponent of any adjustment need only go forward with sufficient evidence to support its reasonableness.⁶ I&E contends Twin Lakes has failed to carry its burden of proof with respect to its proposal to increase its revenues by \$211,793.

² See *Brockaway Glass v. Pa. P.U.C.*, 437 A.2d 1067 (Pa. Cmwlth. 1981); *Lower Frederick Township v. Pa. P.U.C.*, 409 A.2d 505 (Pa. Cmwlth. 1980).

³ *Dutchland Tours, Inc. v. Pa. P.U.C.*, 337 A.2d 922, 925 (Pa. Cmwlth. 1975).

⁴ See e.g. *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 236 PUR 4th 218 (2004); *Pa. P.U.C. v. Pennsylvania-American Water Company*, 2002 Pa. P.U.C. LEXIS 1 (January 25, 2002).

⁵ *Pa. P.U.C. v. Equitable Gas Company*, 57 Pa. P.U.C. 423, 444, note 37 (1983).

⁶ *Pa. P.U.C. v. West Penn Power Company*, 69 PUR 4th 470, 59 Pa. P.U.C. 552 (1985).

II. SUMMARY OF ARGUMENT

Twin Lakes has failed to adduce substantial credible evidence demonstrating that its requested \$211,793 revenue increase is warranted. Based upon I&E's adjustments, the record evidence proves that Twin Lakes is entitled only to a \$51,098 revenue increase. This recommendation is based upon the expense, rate base and rate of return adjustments offered by I&E, as set forth fully herein.

It is important to note, that one major component to I&E's recommended revenue increase is the denial of Twin Lakes' return on equity due to it providing poor service to customers. If the ALJ and Commission find that Twin Lakes is providing adequate service and that a return on equity warranted, I&E's recommended revenue increase would be adjusted to \$111,777. However, the recommended 0.00% equity return is warranted given the Company's failure to provide safe and reliable service as mandated under the Public Utility Code.⁷ Specifically, the Company's system has one functional well (Well #2) and one non-functional well (Well #1). Well #1 is not operational because the Company has excessive UFW, averaging 80.5% for the years ending December 31, 2015, 2016, 2017, and 2018, which causes the wells to over-pump and "stresses the wells to the point where their operational viability is at risk."⁸ The over pumping caused Well #1 to collapse so it is no longer functioning, which has increased the stress on Well #2 as it is the only well that is currently able to serve customers. According to the Company, the continued over-pumping of Well #2 is placing that well at increased risk of collapse.⁹

⁷ 66 Pa. C.S. § 1501.

⁸ Twin Lakes St. No. 3, p. 2.

⁹ Twin Lakes St. No. 3, p. 2

This threat is of particular concern because Well #2 is currently operating with no backup. These service issues date back to when the Commission approved the sale of Twin Lakes to Middlesex in February 2009, and over the past decade have only continued to deteriorate. As will be discussed more fully below, the two prior rate cases included settlement terms that were designed to address and improve the distribution system; however, the Company failed to fulfill those terms putting reliable and adequate water service to Twin Lakes customers in jeopardy. Additionally, while this base rate case was being litigated, the Pennsylvania Department of Environmental Protection issued a notice on November 13, 2019 detailing elevated levels of lead found in drinking water tap samples taken from the Twin Lakes' system. Accordingly, I&E maintains that the recommended 0.00% return on equity ("ROE") is warranted.

III. RATE BASE

A. Plant in Service

In this proceeding the Company used a historic test year ("HTY") ending March 31, 2019. The depreciated original cost claimed by Twin Lakes in this proceeding is \$1,443,561. Twin Lakes further claimed projected plant in service additions from April 1, 2019 to September 30, 2019 of \$37,500.¹⁰ This resulted in a total plant in service balance of \$1,481,060.¹¹ I&E witness Sakaya accepted the Company's proposal to reflect the post-test year pro forma plant in service additions and accumulated

¹⁰ I&E St. No. 3, p. 12.

¹¹ *Id.*

depreciation from April 1, 2019 to September 30, 2019. Therefore, the total plant in service balance of \$1,481,060 less the accumulated depreciation balance of \$219,884 results in a total net plant of \$1,261,176.¹² The Company has claimed an acquisition adjustment in the amount of \$54,406 and \$17,175 in cash working capital as additions to rate base. The only deduction to rate base claimed by the Company is \$25,047 in deferred income taxes. This results in a total rate base of \$1,307,710 which serves as the starting point for any further I&E adjustments to rate base.

B. Depreciation Reserve

I&E has not proposed a depreciation reserve adjustment to rate base.

C. Additions to Rate Base

1. Acquisition Adjustment

The Company is claiming a \$54,406 positive acquisition adjustment related to it being acquired by Middlesex Water Company in 2009. An acquisition adjustment is the ratemaking treatment of the difference between the purchase price of the acquired system and the value of the depreciated original cost of the system being acquired.¹³ A positive acquisition adjustment occurs when the depreciated original cost of the acquired facilities is less than the purchase price for the facilities. The acquisition adjustment is amortized over a specific period of time, as an expense, thus reducing the difference. Section 1327(a) of the Code establishes nine criteria that must be met before a utility can claim an acquisition adjustment in rate base.¹⁴

¹² I&E Ex. No. 3, Sch. 4, p. 2 line 3.

¹³ I&E St. No. 3, p. 13.

¹⁴ 66 Pa. C.S. § 1327.

When Middlesex Water Company acquired Twin Lakes Water, LLC in November of 2009, the purchase price was \$99,410 while the net book value was \$79,726. Therefore, the purchase price was \$19,684 above net plant value resulting in a positive acquisition adjustment. As explained by both I&E and OCA, and acknowledged by the Company, the Commission, while approving the acquisition itself, never specifically approved any acquisition adjustment.¹⁵ In this proceeding, I&E did not challenge the validity of the acquisition adjustment, but merely the amount of the adjustment.

I&E recommends that the positive acquisition adjustment be reduced by \$18,388, from \$54,406 to \$36,018.¹⁶ In the Twin Lakes 2011 rate proceeding it claimed a positive acquisition adjustment of \$71,440 and in its 2015 base rate proceeding it claimed a positive acquisition adjustment amount of \$54,406. The Company is continuing to claim a positive acquisition amount of \$54,406 in the instant proceeding, meaning that no reduction to this amount has been reflected since 2015.¹⁷ Twin Lakes disagrees with I&E's recommended reduction to the acquisition adjustment stating that it should receive the full amount as a result of the Commission's failure to rule on the treatment of the acquisition adjustment in either the 2011 proceeding or the 2015 proceeding.¹⁸ The Company's logic is flawed and ignores the appropriate ratemaking treatment of acquisition adjustments. As explained by I&E witness Sakaya, it would be improper not to reflect a reduction to the value of the acquisition adjustment because to do so would

¹⁵ I&E St. No. 3, p. 14, and OCA St. No. 1, p. 4.

¹⁶ I&E St. No. 3, p. 18.

¹⁷ I&E St. No. 3-SR, p. 6.

¹⁸ Twin Lakes St. MLT-R, pp. 3-4.

necessarily allow the Company to earn a return on the overpayment for this system into perpetuity.¹⁹

I&E witness Sakaya calculated this amount by using the amortization schedules established in 2015. The accumulated amortization amount of \$35,422 was subtracted from the corrected acquisition adjustment amount of \$71,440. Using those 2015 amortization schedules where the \$71,440 acquisition adjustment amount would be paid over a 20-year period resulted in an annual amortization expense of \$3,572. Amortizations should have accumulated over approximately 10 years at this point, resulting in a total of \$35,422 for this ten-year period. This results in a residual \$36,018 acquisition adjustment as of September 30, 2019.²⁰ When this residual amount is subtracted from the Company's claimed \$54,406 it results in a downward adjustment to rate base of \$18,388.

As explain in testimony it does appear that Twin Lakes was properly reflecting an amortization of the acquisition amounts between the 2011 and 2015 rate cases.²¹ Therefore, it stands to reason that the Company understood, at least at one point, that there was supposed to be a certain amount amortized over a certain period of time related to this positive acquisition adjustment. This is reasonable because as I&E witness Sakaya stated, “[s]ince the difference is the result of the level of new plant compared to the

¹⁹ I&E St. No. 3-SR, p. 9.

²⁰ I&E St. No. 3, p. 19.

²¹ I&E St. No. 3-SR, p. 11.

purchase price, it is reasonable to reduce the acquisition adjustment over time similar to the way plant depreciates over time.”²²

While I&E does not dispute that the system was in poor condition when it was acquired, this simply does not justify the Company continuing to earn a return on its overpayment for eternity.²³ Sound ratemaking principles require that this amount be amortized over time. Further the Company’s claims that I&E’s adjustment would constitute retroactive ratemaking are without merit. The policy reasons behind the rule prohibiting retroactive ratemaking are:

“...that if retroactive ratemaking is allowed, it makes the ‘test year’ method of ratemaking meaningless and the general principle that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use. This court has stated the rule as ‘[t]he Commission clearly may not establish rates which are calculated to retroactively recover surpluses or refund deficits created by inaccuracies in its prior rate authorizations.’”²⁴

This is simply not the case regarding the instant issue. First, as noted above, it appears that at some point, the Company did recognize that an amortization was required as it was reflected in the interim between the 2011 and 2015 cases. Second, as I&E witness Sakaya explained this is similar to the way plant depreciates over time since the difference is the result of the level of net plant compared to the purchase price.²⁵

As has been shown, I&E’s adjustment was calculated in a reasonable manner and is reflective of the way the Commission generally treats acquisition adjustments. The

²² I&E St. No. 3, p. 19.

²³ I&E St. No. 3-SR, p. 9.

²⁴ *Popowsky v. Pa. P.U.C.* 164 Pa. Cmwlth. 338, 344, 642 A.2d 648, 651 (1994).

²⁵ I&E St. No. 3, p. 19.

Company has failed to show why they should be allowed earn a return on their overpayment for this system in perpetuity. Therefore, I&E requests the ALJ recommend and the Commission order Twin Lakes to reflect a reduction of this acquisition adjustment of \$18,388 for a total positive acquisition adjustment of \$36,018.

D. Deductions to Rate Base

1. Cash Working Capital

I&E witness John Zalesky presents I&E's adjustment to Twin Lakes claim for cash working capital. Cash working capital ("CWC") is a measure of liquidity necessary to cover expenses as they are incurred and payable while recovering revenues as they are due and receivable. For ratemaking purposes, CWC is the amount of capital a utility requires to cover the lag between the dates for the payment of operating expenses and taxes and the utility's receipt of revenues from ratepayers. While the Company has claimed CWC as an addition to rate base,²⁶ in this instance, I&E witness Zalesky has made a downward adjustment to CWC, thus necessitating a reduction to rate base.

Twin Lakes' total CWC claim is \$17,175 using the one-eighth method.²⁷ The one-eighth method uses a net O&M expense amount, which is the total O&M expense claim reduced by any non-cash O&M expense items.²⁸ The net O&M expense amount is multiplied by 1/8 to produce a CWC allowance to be included in rate base.²⁹ The result approximates a company's committed funds. I&E witness Zalesky agrees that the one-

²⁶ I&E St. No. 3, p. 11.

²⁷ I&E Exhibit No. 1, Schedule 1, p. 2.

²⁸ I&E St. No. 1, pp. 23-24.

²⁹ I&E St. No. 1, p. 24.

eighth method is appropriate but disagrees with the Company's inclusion of non-cash items such as bad debt expense and depreciation expense in calculating the Company's CWC claim.³⁰ Non-cash items should not be included in the calculation of CWC because these expenses do not require cash, and therefore should not be included in CWC. Therefore, witness Zalesky recommends an allowance of \$12,423 or a reduction of \$4,752 to the Company's claim.³¹

Twin Lakes witness Tilley disagrees with I&E and asserts that depreciation and bad debt expense should be included in the calculation of CWC.³² Ms. Tilley's argument for depreciation to be included in CWC was based on the belief it would compensate for revenue lag.³³ This argument fails because expense lags only pertain to the lead-lag study method of calculating CWC; however, here the one-eighth method is utilized.³⁴ Further, CWC should only include cash expenses to cover the delay of cash revenues.

Next, Twin Lakes argued that its bad debt expense should be included in the calculation for CWC.³⁵ This is incorrect as bad debt expense, calculated as a function of revenue, is accounted for in the ratemaking formula as an expense in which the Company receives dollar for dollar recovery of its bad debt expense allowance.³⁶ Again, the Company claims that without including bad debt expense it would increase revenue lag. The Company ignores the fact that revenue lag pertains to the lead-lag study of

³⁰ *Id.*

³¹ I&E St. No. 1, p. 25.

³² Twin Lakes St. MLT-R, p. 6.

³³ Twin Lakes St. MLT-R, p. 8.

³⁴ I&E St. No. 1-SR, p. 13.

³⁵ Twin Lakes St. MLT-R, p. 8.

³⁶ I&E St. No. 1-SR, p. 13.

computing CWC and not to the one-eighth method. Both depreciation and bad debt expense are properly excluded from I&E's recommendation. Therefore, I&E's CWC recommendation of \$12,423 or a reduction of \$4,752 to the Company's claim should be accepted.³⁷

This Commission has long recognized that non-cash items, such as depreciation and uncollectibles, are not appropriate in the determination of cash working capital requirements.³⁸ In *Pa. P.U.C. v. Metropolitan Edison* and *Pa. P.U.C. v. Pennsylvania Electric Company*, the Commission held:

Our review of the record evidence leads us to conclude that the ALJs recommendation relative to the treatment of "non-cash" items within the cash working capital analysis is reasonable and consistent with Commission precedent. We find that the OCA's position that depreciation, amortization, deferred income taxes and uncollectibles are not cash expenses for which a payment must be made at a specified date is correct. Therefore, these expenses are not properly included in the lead-lag study analysis to determine cash working capital. We are not persuaded by the Companies' arguments to deviate from our prior decisions on this issue and will continue to follow Commission precedent.³⁹

³⁷ I&E St. No. 1-SR, p. 14.

³⁸ *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 58 Pa. P.U.C. 668, 674 (1984) ("we consider uncollectible accounts expense to be a non-cash expense and, as such; no return allowance will be granted"); *Pa. P.U.C. v. Mechanicsburg Water Co.*, 80 Pa. P.U.C. 212, 226 (1993) (the Commission adopted the OCA's adjustment to eliminate non-cash items, such as amortization and written-off uncollectibles from the cash working capital calculation); *Pennsylvania Public Utility Commission v. Dauphin Consolidated Water Supply Company*, 71 Pa. P.U.C. 555, 563-564 (1989)(the Commission determined that non-cash items such as uncollectible expense do not require the utility to use cash funds and are already recovered as expenses.) *Pa. P.U.C. v. Columbia Gas of Pa, Inc.*, 74 Pa. P.U.C. 282, 300 (1990) ("any expense which does not require the utility to utilize cash funds does not require a CWC allowance").

³⁹ *Pa. P.U.C. v. Metropolitan Edison Company*. Docket No. R- 00061366, p. 32 (Order entered January 11, 2007); *Pa. P.U.C. v. Pennsylvania Electric Company*. Docket No. R-00061367, p. 32 (Order entered January 11, 2007).

Additionally, it is important to highlight that the Commission has consistently disallowed the inclusion of non-cash items in the CWC calculation regardless of the utility's size. Specifically, in the Emporium Water Company Order the Commission expressly disallowed uncollectibles expenses from the CWC calculation and was not persuaded by Emporium Water's claim that it should be permitted due to the small size of the company.⁴⁰ In that proceeding, the Commission reaffirmed its long-standing position that only cash items should be included in the calculation regardless of the utility's size.

E. Conclusion

A company's rate base is the total net investment in plant, materials, inventory and cash a utility has in place to serve customers. In the rate making formula, the rate base is multiplied by a utility's allowed rate of return to determine the income in excess of expense that a utility is granted the opportunity to earn through rates. As noted in I&E witness Sakaya's testimony, rate base is the depreciated original cost of a utility's investment in plant determined to be used and useful in the public service at the end of the test year, plus other additions and deductions that the Commission determines are necessary in order for the utility to continue to operate in a safe and reliable manner.⁴¹ The depreciated original cost for plant in service is determined by subtracting the book reserve, which is the accumulation of all prior annual depreciation expense, and other items such as salvage value from the original cost of the plant in service that is used and useful at the end of the test year.

⁴⁰ *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324, pp. 10-11 (Order entered January 28, 2015).

⁴¹ I&E St. No. 3, p. 10.

As explained above, I&E recommends an adjustment to the Company's rate base related to the acquisition adjustment currently on its books. This is a downward adjustment of \$18,388 for a total rate base of \$1,289,322. I&E witness Zalesky further recommended a CWC downward adjustment of \$4,752. This results in a total I&E recommended allowed rate base of \$1,284,570.

IV. REVENUES

Twin Lakes reported its revenues as of March 31, 2019, or the end of the historic test year, as \$133,514.⁴² If granted the full increase, Twin Lakes would earn approximately \$211,793 in annual revenue as a result of this filing.⁴³ As explained further below, I&E recommended that if less than the full increase is granted, rates should be scaled back proportionally.⁴⁴ Apart from this recommendation, I&E made no further adjustments to revenues.

V. EXPENSES

A. Rate Case Expense

The estimated costs that comprise a company's allowable claim for rate case expense are those that are prudently incurred to compile, present, and defend a request to increase base rates.⁴⁵ These estimated costs typically include legal fees for outside counsel, outside consultants and the costs of printing, collating and postal expenses.⁴⁶ In

⁴² I&E St. No. 3, p. 25.

⁴³ I&E St. No. 3, p. 26.

⁴⁴ I&E St. No. 3, p. 26.

⁴⁵ I&E St. No. 1, p. 4.

⁴⁶ I&E St. No. 1, p. 4; *Butler Township Water Company v. Pa. P.U.C.*, 473 A.2d 219 (Pa. Cmwlth. 1984).

this proceeding, the Company has estimated a fully litigated rate case expense of \$86,000 to be amortized over 18 months for an annual expense of \$57,333.⁴⁷

I&E witness Zalesky recommends a rate case expense allowance of \$26,462 or a reduction of \$30,871 from the Company's claim.⁴⁸ Mr. Zalesky's recommendation is the result of two adjustments. First, he adjusts the Company's proposed amortization period to a normalization period. Second, Mr. Zalesky recommends that the expense be normalized over 39 months to reflect Twin Lakes historical filing history.

The Commission consistently considers prudently incurred rate case expense as an ongoing expense, recurring at irregular intervals; therefore, the expense is routinely normalized and not amortized.⁴⁹ Amortization is an accounting term for a process that extinguishes an atypical, nonrecurring expense over a pre-determined number of months or years by charging to operations, a pro rata share based on the appropriate amortization period. An amortization expense allowance could be claimed in succeeding rate cases as long as there is a remaining unamortized balance.⁵⁰ In contrast, normalization is a ratemaking concept that transforms an operating expense that recurs at irregular intervals into a "normal" annual test year expense allowance. Normalization specifically addresses

⁴⁷ Twin Lakes Exhibit MLT-2 and I&E Exhibit No. 1, Schedule 2.

⁴⁸ I&E St. No. 1-SR, p. 5.

⁴⁹ I&E St. 2 at 11; *Pa. P.U.C. v. Apollo Gas Co.*, 54 Pa. P.U.C. 358, 373 (1980); *See also Pa. P.U.C. v. Carnegie Natural Gas Co.*, 54 Pa. P.U.C. 381 (1980); *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, 54 Pa. P.U.C. 401, 416-417 (1980); *Pa. P.U.C. v. Philadelphia Electric Co.*, 56 Pa. P.U.C. 155, 176 (1982); *Pa. P.U.C. v. West Penn Power Company*, 73 Pa. P.U.C. 454 (1990); *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, 73 Pa. P.U.C. 552 (1990).

⁵⁰ *Pa. P.U.C. v. Apollo Gas Co.*, 54 Pa. P.U.C. 358, 373 (1980); *See, also, Pa. P.U.C. v. Carnegie Natural Gas Co.*, 54 Pa. P.U.C. 381 (1980); *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, 54 Pa. P.U.C. 401, 416-417 (1980); *Pa. P.U.C. v. Philadelphia Electric Co.*, 56 Pa. P.U.C. 155, 176 (1982); *Pa. P.U.C. v. West Penn Power Company*, 73 Pa. P.U.C. 454 (1990); *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, 73 Pa. P.U.C. 552 (1990).

the prospective recovery of an ongoing expense that recurs sporadically. Allowed normalized expenses are no different than any other O&M expense in that the company is given the opportunity to achieve full recovery, with the prospect for an over or under recovery dependent upon the timing of when a company's next base rate case change will become effective. Unlike expenses that are amortized, a claim for an unrecovered normalized expense would be disallowed if requested in a subsequent base rate case because the rate case gives the opportunity to reevaluate and represent the normalized level of expense. While the Company's rebuttal testimony was not entirely clear, it appears to continue to believe that its rate case expense should be amortized. This contradicts the Commission's well settled position that such expenses are routinely normalized.⁵¹ As stated in the Commission's recent Guide to Utility Ratemaking: "The Commission's practice is to recognize all prudently-incurred rate case expense and set a normalization period based upon historic filing frequency."⁵² Therefore, the Company's request to amortize this expense should be rejected.

The next area of disagreement is the appropriate normalization period with respect to the period over which to normalize this expense, Twin Lakes witness Tilley disagreed with I&E's recommended 49-month normalization period presented in direct testimony.⁵³ Ms. Tilley believed that I&E should have considered the acquisition date of November 9,

⁵¹ *A Guide to Utility Ratemaking*, James H. Cawley and Norman J. Kennard (2018 Edition) p. 86.

⁵² *A Guide to Utility Ratemaking*, James H. Cawley and Norman J. Kennard (2018 Edition) (Emphasis added) p. 112.

⁵³ Twin Lakes St. MLT-R, p. 4.

2009 in determining a normalization period.⁵⁴ In addition, Ms. Tilley is concerned that I&E did not take into consideration the elevated level of planned investment in utility plant that would indicate a need for rate relief sooner than what the historic filing frequency would indicate.⁵⁵ Lastly, Ms. Tilly asserts that with an excessively long normalization period, the Company may never have the opportunity to recover its rate case expense.⁵⁶

Upon consideration of Ms. Tilley’s arguments, I&E witness Zalesky updated his recommendation in surrebuttal testimony that resulted in the rate case expense recommendation of \$26,462.⁵⁷ Specifically, Mr. Zalesky determined it to be fair and reasonable to include the date of acquisition of November 9, 2009 in the historic filing frequency, which decreased I&E’s normalization period from 49-months in direct testimony to 39-months in surrebuttal testimony. Witness Zalesky calculated the 39-month average as follows:

DOCKET NUMBER	DATE FILED	NO. OF MONTHS BETWEEN CASES
R-2019-3010958	July 19, 2019	44
R-2015-2506337	November 16, 2015	53
R-2011-2246415	June 10, 2011	19
A-2008-2050089	November 9, 2009 (effective date)	

$[(44 + 53 + 19) \div 3 \text{ intervals}]$.⁵⁸

⁵⁴ *Id.*
⁵⁵ Twin Lakes St. MLT-R, p. 5.
⁵⁶ *Id.*
⁵⁷ I&E St. No. 1-SR, p. 5.
⁵⁸ I&E St. No. 1-SR, p. 5.

As shown in the table above, the Company's requested 18-month amortization of \$86,000, resulting in an annual expense of \$57,333, is inappropriate as it is unsupported by the Company's historic filing frequency. The Commission has historically utilized a company's historic frequency of rate case filings, as determined by computing the average number of months between rate cases, to be an essential element in determining an appropriate normalized level of rate case expense.⁵⁹ Company witness Tilley opines that "it is imperative to use the correct time period" when normalizing rate case expense because "if the period chosen is inappropriately long, there is a danger that the Company will never have an opportunity to recover the rate case expense."⁶⁰ I&E agrees that the determination of an appropriate period is important and must highlight that choosing an inappropriately short normalization period is imprudent as it will allow the Company to over recover this expense. This demonstrates that ratemaking is not an exact science and there is no guarantee that the Company will collect expenses incurred dollar for dollar. Rather, the Commission has recognized that normalization is a tool to help the parties and the Commission make the test year expense representative of normal operations.⁶¹ The Company's inappropriately short 18-month normalization period is simply not reflective of its operations and will likely result in the Company over-recovering this expense.

⁵⁹ *Pa. P.U.C. v. Borough of Quakertown*, Docket R-2011-2251181, p. 37 (Order entered September 13, 2012); see also, *inter alia*, *Popovsky v. Pa. P.U.C.*, 674 A.2d 1149 (Pa. Cmwlth. 1996); *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, 84 Pa. P.U.C. 134, 175 (1995); *Pa. P.U.C. v. West Penn Power Company*, 119 PUR 4th 110, 149 (Pa. P.U.C. 1990).

⁶⁰ Twin Lakes St. MLT, p. 5.

⁶¹ *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324, p. 48 (Order entered January 28, 2015).

Accordingly, I&E's recommended rate case expense allowance of \$26,462, or a reduction of \$30,871 to the Company's claim should be adopted.

B. Maintenance Supplies

Maintenance supplies expense includes labor and supplies used to maintain utility service. The Company's claim for maintenance supplies is \$9,509 and is based on its expense for the historic test year.⁶² In that year, the Company repaired two main breaks in July 2018 in the amounts of \$4,712 and \$4,797 for a total of \$9,509.⁶³

I&E witness Zalesky disagrees with the Company and recommends an allowance of \$4,499 or a reduction of \$5,010 to the Company's claim.⁶⁴ Mr. Zalesky's recommendation is based on an average of the Company's maintenance supplies expense for the most recent three years: \$3,558 for the twelve months ended March 31, 2017; \$430 for twelve months ended March 31, 2018; and \$9,509 for the HTY, producing the average of \$4,499.⁶⁵ Mr. Zalesky's recommendation normalizes the two water main repair expenses experienced in the HTY, each of which was more than maintenance supplies expense for the previous two years. As a result, the three-year historic average is a more reliable estimate for a future projection because it is short enough to disregard any irrelevant older data but long enough to smooth out any anomalies such as the two main breaks that occurred in the HTY.

⁶² Twin Lakes filing, Schedule D, column 6.

⁶³ I&E Exhibit No. 1, Schedule 4, pp. 1-3.

⁶⁴ I&E St. No. 1, p. 11.

⁶⁵ *Id.*

Twin Lakes did not respond to Mr. Zalesky's recommendation in Rebuttal Testimony therefore, I&E's recommendation is undisputed and should be accepted.

C. Purchased Power

I&E's purchased power adjustment consists of two components. The first component is contained in I&E witness Zalesky's testimony related to the Company paying more than the Price to Compare for generation and transmission charges. The second component is contained in I&E witness Sakaya's testimony and reflects an adjustment related to the extremely high levels of unaccounted-for water experienced by the Company. It should be noted that I&E witness Sakaya's recommendation also contains an adjustment for chemical expense. As these two components are intrinsically tied to one another, both components of witness Sakaya's adjustment are discussed in this section.

1. Price to Compare Adjustment

Purchased power expense consists of a claim for electric power used for operations. The Company is claiming \$10,524 for purchased power based on the historic test year.⁶⁶ I&E disagrees with the Company's claim and recommends an allowance of \$7,520 or a reduction of \$3,004 to the Company's claim.⁶⁷

I&E witness Zalesky examined the Company's electric bills from April 2016 to August 2019 in determining his recommendation.⁶⁸ Mr. Zalesky's analysis indicated that the Company paid more than the Price to Compare ("PTC") for generation and

⁶⁶ Twin Lakes Filing, Schedule D, column 6.

⁶⁷ I&E St. No. 1, p. 12.

⁶⁸ I&E St. No. 1, p. 13.

transmission charges in all months but one (May 2016). In the twelve months ended March 31, 2017, the Company overpaid by \$872 and incurred a late charge of \$21 for the bill due September 30, 2016. Further, the Company overpaid for generation and transmission charges by \$912 for the twelve months ended March 31, 2018 and paid a late payment charge of \$22 for the bill due October 2, 2017. Finally, for the twelve months ended March 31, 2019, upon which the Company based its claim, the Company overpaid for generation and transmission charges by \$2,975 and incurred a late payment charge of \$29 for the bill due March 1, 2019 for a total of \$3,004.⁶⁹ Mr. Zalesky's adjustment reflects the amount for which ratepayers should be responsible. Further, this adjustment reflects a more appropriate amount for generation and transmission charges based on the Price to Compare.

A fundamental ratemaking principle is that a public utility is entitled to recover all reasonable and normal operating and maintenance expenses incurred by providing regulated service.⁷⁰ However, to the extent that expenses are not incurred, imprudently incurred, or abnormally overstated during the test year, they should be disallowed and not recoverable through rates. Here, the Company paid more than the PTC in all but one of the 39 months analyzed by I&E, resulting in approximately \$3,000 additional generation and transmission charges in the HTY. Twin Lakes should not be permitted to recover this imprudent expense from its customers. I&E's adjustment is conservative considering the Company should be able to find rates below the Price to Compare. Furthermore,

⁶⁹ *Id.*

⁷⁰ *Western Pennsylvania Water Company v. Pa. P.U.C.*, 422 A.2d 906 (Pa. Cmwlth. 1980).

Twin Lakes has already overpaid for generation and transmission charges by \$1,691 for the first five months beyond the HTY. At this rate, Mr. Zalesky aptly points out, the Company would overpay for generation and transmission charges by \$4,059 for the year, which exceeds his recommended adjustment by \$3,004.⁷¹ Going forward, the Company should take whatever actions necessary to ensure it does not pay more for electric supply than PPL's currently effective Price to Compare as ratepayers should not be required to pay electric supply rates higher than the Price to Compare.

Twin Lakes rejected I&E's purchased power recommendation but only directly responded to purchased power and chemical adjustment. As the Company did not refute the overpayment for generation and transmission, I&E requests its recommended allowance for purchase power of \$7,520 be accepted.

2. Unaccounted-For Water Adjustment

Unaccounted-for water is the amount of water lost when comparing the total system output, with the volume of water sold, the amount estimated to be used in areas such as fire service, testing, flushing and company use water. The amount in excess of the total system output and those amounts a company can account for the use of in other areas is considered lost and unaccounted-for. In general, the main causes that contribute to unaccounted for water are leaks in mains, hydrants and services, theft, inaccurate meter reading, and natural losses. The Commission considers levels above 20% as excessive.⁷² As noted by I&E witness Sakaya, it is important to reduce unaccounted-for water to

⁷¹ I&E St. No. 1, p. 14.

⁷² 52 Pa. Code § 65.20(4).

reasonable levels because it reduces the amount of water that ultimately needs to be pumped, treated and sent to customers, while increasing the amounts available during peak demand and improving overall service quality.⁷³

In the instant proceeding, the Company reported that for the years ended December 31, 2015 through December 31, 2018, unaccounted-for water percentages averaged 80.5%.⁷⁴ This amount is clearly in excess of what the Commission considers reasonable. Therefore, I&E witness Sakaya recommended that claims for Purchased Power related to Water Treatment Expense and Chemicals be reduced from \$10,523 by \$6,388 to \$4,135 because it is not reasonable for ratepayers to pay for the cost to treat and pump excessive levels of water that is ultimately lost and not used to serve customers.⁷⁵

Excessive unaccounted-for water has been an ongoing problem in the Company's distribution system. The Company has previously proposed to reduce unaccounted-for water levels but has thus far been unsuccessful. In the 2011 base rate proceeding, as part of the Joint Petition for Settlement, the Company agreed that it would reduce its then 55% unaccounted for water level by 10% by September 3, 2013.⁷⁶ It further agreed that over the subsequent 4 year period, it would continue to reduce unaccounted-for water levels by 10% each year.⁷⁷ Yet, instead of decreasing, the unaccounted-for water levels continued to rise ranging from 78.7% to 82.9% in 2015-2018.⁷⁸ Once again, as part of the

⁷³ I&E St. No. 3, pp. 3-4.

⁷⁴ I&E St. No. 3, p. 4.

⁷⁵ I&E St. No. 3, p. 9.

⁷⁶ *Pennsylvania Public Utility Commission v. Twin Lakes Utilities, Inc.*, Docket No. R-2011-2246415, pp. 10, 20-21 (Recommended Decision dated January 18, 2012).

⁷⁷ *Id.*

⁷⁸ I&E St. No. 3, pp. 5-6.

Joint Settlement of the 2015 base rate proceeding, the Company agreed to certain measures that would help remedy the unaccounted-for water levels. As part of that Settlement, the Company agreed to a 3-year phase-in of rates. The triggering event for the year 3 rate increase was the replacement of certain older service lines.⁷⁹ Of the 4,000 feet of mains the Company agreed to replace in the 2015 proceeding, the Company has only replaced 2,790 feet.⁸⁰ The replacement of these older service lines has not had a material impact on the high levels of unaccounted-for water given that the lost water was 82.9% in 2015, 79.1% in 2016, 78.7% in 2017 and 81.3% in 2018.⁸¹ The Company blames the excessively high unaccounted-for water levels on age and quality of the original pipe materials, and poor workmanship related to leak repairs, all of which it states took place before the current owner acquired the system;⁸² however, it still remains, that the current owner is required to provide safe and reliable service to its customers. Lines that leak over 80% of the water passed through them are arguably neither safe, nor reliable. Moreover, the current owner made commitments in both the 2011 and 2015 rate case settlements to address the excessive unaccounted-for water issue and it failed to adhere to those commitments.

As it currently stands, of the water treated and passed through this system merely 19.5% actually makes it to the end user. It is, therefore, unacceptable to ask those same customers to pay for treatment and pumping expenses of water that they will never see.

⁷⁹ *Pennsylvania Public Utility Commission v. Twin Lakes Utilities, Inc.*, Docket No. R-2015-2506337, pp. 9-11, 20-22 (Recommended Decision dated April 21, 2016).

⁸⁰ I&E St. No. 3, p. 7.

⁸¹ I&E St. No. 3, p. 6.

⁸² Twin Lakes St. RKF-R, p. 2.

I&E's recommendation is consistent with the Commission's policy statement on water conservation, which established criteria to encourage cost-effective water conservation and expressly states that the Company's failure to satisfy the criteria may impact the determination of just and reasonable rates:

In rate proceedings of water utilities, the Commission intends to examine specific factors regarding the action or failure to act to encourage cost-effective conservation by their customers. Specifically, the Commission will review utilities' efforts to meet the criteria in this section when determining just and reasonable rates and may consider those efforts in other proceedings instituted by the Commission.

(4) *Unaccounted-for water.* Levels of unaccounted-for water should be kept within reasonable amounts. Levels above 20% have been considered by the Commission to be excessive.⁸³

The Commission has disallowed recovery of these expenses in far less extreme circumstances than presented here. For example, in Emporium Water's 2006 rate case, the Commission disallowed the recovery of pumping and treatment expenses due to the company's unaccounted-for water range of 29.41% to 37.7% in the test year.⁸⁴ In *Emporium*, the Commission correctly determined that it was not just or reasonable to

⁸³ 52 Pa. Code § 65.20.

⁸⁴ *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-00061297, p. 31 (Order entered Dec. 28, 2006).

require customers to pay for the additional cost to treat and pump the lost water:

Though the Company's system is old, the obligation to maintain the system must be met and it has not presented us with technical evidence of any mitigating factors in this regard. (R.D. at 34-35). We note that the Company's ratepayers have been paying for leak detection and system repairs on an ongoing basis, and we consider that it would be unfair to add to their rates by including the costs of a high level of unaccounted-for water.⁸⁵

Similarly, it is not just and reasonable to require Twin Lakes customers to pay for the far more excessive water losses ranging from 78.7% to 82.9% in the 2015-2018 period. In order to recover these costs, the Commission has required water companies with unaccounted for water levels in excess of the 20% benchmark to demonstrate by way of substantial evidence that their experience is both normal and reasonable by providing evidence (i.e., engineering, operations or historical testimony) to support the argument that these levels are reasonable.⁸⁶ Those companies that are unable to support with substantial evidence that the excessive levels of unaccounted-for water they are experiencing are normal and reasonable have been subjected to a downward adjustment in operating and maintenance expenses.⁸⁷ Here, the Company failed to provide substantial evidence that its extreme losses are normal or reasonable. As discussed above, I&E has entered into two prior settlements with Twin Lakes with terms that were designed to address the excessive unaccounted-for water in its system. Those settlements

⁸⁵ *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-00061297, p. 34 (Order entered Dec. 28, 2006).

⁸⁶ *Pennsylvania Public Utility Commission v. Dauphin Consolidated Water Supply Company*, 55 Pa. P.U.C. 202, 203 (1981).

⁸⁷ *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-00061297, pp. 31-32 (Order entered Dec. 28, 2006).

failed to remedy the problem; therefore, disallowing the excessive costs in this proceeding is warranted.

To arrive at his adjustment, I&E witness Sakaya first accepted the Company's claim for chemical expense of \$3,003. He then added that amount to I&E witness Zalesky's purchase power expense recommendation of \$7,520 which is discussed in more detail herein. This resulted in a total of \$10,523 related to the cost of water production. Any cost related to producing water above the Commission's threshold of 20% unaccounted-for water should not be borne by ratepayers.⁸⁸ The excess gallons above the 20% threshold amount to 10,004,450 gallons.⁸⁹ Therefore, to arrive at the amount by which the costs associated with the production of water must be reduced, I&E witness Sakaya multiplied the excess gallons (those above the 20% threshold) by the incremental cost of water production of \$0.6385 per thousand gallons to arrive at \$6,388.⁹⁰

Currently less than 20% of the water customers pay to have treated and pumped through this system actually makes it to the end user. In 2018 alone, the Company's unaccounted-for water totaled 15,813,000 gallons.⁹¹ These losses are staggering especially given that the Company is proposing to charge ratepayers \$38.33 for every 1,000 gallons used.⁹² Requiring ratepayers to pay an exorbitant amount per 1,000 gallons used and to also pay for the chemicals and power that treat 15,813,000 gallons of water that is lost in the distribution system is contrary to sound ratemaking principles and the

⁸⁸ I&E St. No. 3, p. 7.

⁸⁹ I&E St. No. 3, p. 9, and I&E Ex. No. 3, Sch. 3, p. 2, line 6, col. F.

⁹⁰ *Id.*

⁹¹ I&E St. No. 3, p. 7.

⁹² I&E St. No. 3, p. 7.

public interest. As discussed above Company witness Fullagar's explanation of why the levels of unaccounted-for water are so high consists merely of placing the blame on the prior owners of Twin Lakes. This testimony certainly does not rise to the level of substantial evidence that the Commission requires to find that these levels of unaccounted-for water are reasonable and normal. I&E witness Sakaya's position is reasonable and supported by substantial evidence as well as Commission precedent. Further, as explained by witness Sakaya, by reducing levels of unaccounted-for water, the Company reduces the amount of water it needs to treat and pump to end users. By taking measures to reduce the amount of unaccounted-for water the Company will actually be mitigating the impact of witness Sakaya's recommendation. The Public Utility Code at 66 Pa. C.S. § 1501 obligates Twin Lakes to provide safe and reliable service regardless of what occurred under any previous owner. Substantial progress must be made toward reducing the amount of unaccounted-for water in this system. Asking customers to pay for 100% of the cost to treat and pump water when less than 20% actually makes it to their taps is irresponsible and unacceptable. Twin Lakes has failed to meet its burden to demonstrate that the excessive levels of unaccounted-for water it experiences is normal and reasonable. I&E witness Sakaya has presented a reasonable calculation of the amount by which purchased power and chemical expense should be reduced. This is also a reasonable solution to the overall problem as it incentivizes Twin Lakes to reduce the overall level of unaccounted-for water because this will, in turn, minimize the effect of this adjustment.

Therefore, I&E requests that the ALJ recommend and the Commission order Twin Lakes to reduce their claims for purchased power and chemical expense by \$6,388 to \$4,135 to account for the excessive levels of unaccounted-for water.

3. Conclusion

I&E recommends an overall downward adjustment to purchased power and chemical expense of \$9,392. This reflects I&E witness Zalesky's adjustment of \$3,004 and I&E witness Sakaya's adjustment of \$6,388. As noted above, I&E witness Zalesky's recommended allowance of \$7,520 was not addressed by the Company and as the recommendation is uncontested, it should be approved. Further, as demonstrated in testimony and in brief, it is unreasonable to require ratepayers to pay 100% for the pumping and treatment of water when less than 20% of that water will make it to the end user. I&E witness Sakaya has presented a reasonable adjustment to this expense which results in ratepayers paying for a level of unaccounted-for water that is closer to what the Commission considers reasonable. The Company can mitigate the impact of this adjustment by reducing levels of unaccounted for water which, in turn, will also benefit ratepayers by providing them with safer and more reliable service.

D. Bad Debt Expense

Uncollectible accounts, or what the Company refers to as bad debt expense, are specific receivables that are determined to be uncollectable in whole or in part, either because the debtors do not pay or because the creditor finds it impracticable to enforce

payment.⁹³ Those accounts deemed uncollectable are charged against income.⁹⁴ For ratemaking purposes, utilities compute uncollectible accounts expense on an annual prospective basis. While the uncollectible accounts expense is a prospective claim, the proper calculation begins with an historic analysis of actual net write-offs to gross write-offs less recoveries of amounts previously written off.⁹⁵ This ratio is then applied to projected revenues to determine the proper prospective allowance. Normally, the historic analysis is based on several years of data.

The Company's claim for bad debt expense is \$19,095, which was based on its amount of bad debt expense for the twelve months ended March 31, 2019 of \$7,384 and increased by the proposed rate increase of 158.6% ($\$7,384 \times [1 + 1.586] = \$19,095$).⁹⁶ I&E witness Zalesky recommends an allowance of \$3,062 or a reduction of \$16,033 to the Company's claim.⁹⁷ I&E witness Zalesky bases his claim on an average percentage of the net write-offs to gross revenues for the three historic twelve-month periods ended March 31, 2017, 2018, and 2019. The average percentage of the net write-offs was 2.35%. Mr. Zalesky then multiplied the percentage by HTY Present Rate Revenues of \$130,279 to calculate the bad debt expense of \$3,062.⁹⁸

⁹³ I&E St. No. 1, p. 15.

⁹⁴ *Id.*

⁹⁵ I&E St. No. 1, p. 15.

⁹⁶ Twin Lakes filing, Schedule D, column 6; Twin Lakes St. No. 2, p. 7.

⁹⁷ I&E St. No. 1, p. 16.

⁹⁸ I&E St. No. 1, p. 17.

In Rebuttal, the Company disagrees with I&E's recommendation and instead believes the bad debt expense should be reflective of what the Company will experience after the rate case when rates will likely be higher.⁹⁹

I&E's recommendation is based on a historical net write-off percentage applied to the Company's HTY revenue. Going forward, I&E believes that the 2.35% should be employed to determine the final bad debt expense allowance once the final revenue requirement is approved by the Commission. Thus, I&E's recommended net write-off percentage will adjust correspondingly to the revenue increase approved in this case.¹⁰⁰

VI. TAXES

I&E witness Zalesky made adjustments to both state and federal taxes as explained in detail below. However, as stated in the footnote on page 2 of witness Zalesky's Direct Testimony, these adjustments would only apply in the situation in which the Commission grants a return on equity to Twin Lakes.¹⁰¹ Should the Commission order that Twin Lakes be granted no return on equity, which is I&E's primary position, state and federal income taxes would already be zero and, thus, no adjustment would be warranted.¹⁰²

⁹⁹ Twin Lakes St. MLT-R, pp. 4-5.

¹⁰⁰ I&E St. No. 1-SR, pp. 9-10.

¹⁰¹ I&E St. No. 1, p. 2, footnote 1.

¹⁰² I&E St. No. 1, p. 3.

A. State Income Taxes

State income taxes are taxes imposed on the net income of a company that does business within the Commonwealth of Pennsylvania as a corporation. The Company's claim for state income taxes is \$10,105.¹⁰³

I&E witness Zalesky proposes a state income tax allowance of \$6,063, which is a \$4,042 reduction to the Company's claim.¹⁰⁴ The primary basis for Mr. Zalesky's adjustment is his recognition that the Company has net operating losses ("NOL") in excess of its net income. Companies with net operating losses available must use them in calculating Pennsylvania Corporate Net Income Tax.¹⁰⁵ Specifically, for tax years beginning after December 31, 2018, companies are limited to an NOL deduction of the lesser of NOLs available or 40% of net income.¹⁰⁶ Here, the Company's test year begins prior to December 31, 2018 therefore the NOL limit of 40% should apply because rates will go into effect after that date and the next tax return period will be after that date.¹⁰⁷

To determine the appropriate state income tax allowance, Mr. Zalesky analyzed the Company's 2017 state tax form and found that the Company had \$559,930 of NOL available for Pennsylvania corporate net income ("PA CNI") tax through the 2017 tax year. Next, Mr. Zalesky looked to the Company's amount of taxable income of \$101,148 as provided in its filing. In this instance, the taxable income is less than the cumulative

¹⁰³ Twin Lakes Filing, Schedule D, column 6.

¹⁰⁴ I&E St. No. 1, p. 18.

¹⁰⁵ *Id.*

¹⁰⁶ PA Corporate Net Income Tax 2018 REV-1200 CT-1 Instructions, p. 16, accessed September 18, 2019: https://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/CorporationTax/Documents/2017/2017_rev-1200.pdf.

¹⁰⁷ I&E St. No. 1, p. 19.

NOL meaning that the maximum NOL allowed is 40% of net income. Twin Lakes' taxable income for PA CNI is \$60,689 and when multiplied by the tax rate of 9.99% leaves I&E's recommended allowance for PA CNI at \$6,063.¹⁰⁸ It is important to note that this adjustment would only apply in the event the Commission allowed a return on equity which is not I&E's primary recommendation of 0% return on equity meaning, our primary recommendation results in no state income tax.¹⁰⁹ In addition, the Company should reflect its NOLs in future base rate filings to appropriately share this reduction in income taxes with ratepayers.¹¹⁰

In rebuttal testimony, the Company neglected to respond to Mr. Zalesky's recommendation, therefore I&E's recommendation should be accepted.

B. Federal Income Taxes

Federal income taxes are taxes imposed by the Internal Revenue Service on annual earnings of individuals, corporations, trusts, and other legal entities. The Company's claim for federal income taxes is \$19,119.¹¹¹

I&E witness Zalesky recommends the disallowance of the Company's claim in its entirety. Similar to the recommendation made concerning state income taxes, witness Zalesky applied the Company's prior year NOLs which completely eliminates the Company's federal income tax claim entirely.¹¹²

¹⁰⁸ I&E St. No. 1, pp. 19-20.

¹⁰⁹ I&E St. No. 1-SR, p. 10.

¹¹⁰ I&E St. No. 1, p. 21.

¹¹¹ Twin Lakes Filing, Schedule D, column 6.

¹¹² I&E St. No. 1, p. 21.

To determine the appropriate federal income tax allowance, witness Zalesky calculated the amount of NOLs available to the Company by analyzing its pro forma Federal Form 1120 its required to file as part of the Pennsylvania state income tax filing. Witness Zalesky constructed a summary between the years of 2009 to 2017 of the Company's NOLs using the base rate filing and responses to data requests.¹¹³ According to the NOL summary, the Company has at least \$458,183 of federal NOLs available. He then considered the portion of net income subject to NOLs as set forth in the Tax Cuts and Jobs Act of 2017 ("TCJA") which allows NOLs earned before the 2018 tax year to cover up to 100% of net income. NOLs earned after the 2017 tax year are eligible to cover up to 80% of net income in any given future year. Here, the Company's NOLs are eligible to cover 100% of net income because they were earned before the 2018 tax year.¹¹⁴

Next, witness Zalesky considered the amount of federal taxable income. Federal taxable income of \$95,085 is equal to Net Income Before Federal & State Income Tax of \$101,148 less PA State Income Tax of \$6,063 as calculated in the previous section of this brief. Because the amount of federal NOL is greater at \$458,183 than the federal taxable income at \$95,085, the Company's entire federal income tax expense claim should be disallowed for ratemaking.¹¹⁵

In rebuttal testimony, the Company neglected to respond to Mr. Zalesky's recommendation, therefore I&E's recommendation should be accepted.

¹¹³ I&E St. No. 1, p. 22.

¹¹⁴ I&E St. No. 1, p. 23.

¹¹⁵ *Id.*

VII. RATE OF RETURN

A. Introduction

In utility ratemaking, the concept of rate of return enjoys the dubious status of being both well-documented legally and highly disputed factually. Simply stated, rate of return is the revenue an investment generates in the form of net income and is generally expressed as a percentage of the amount of capital invested over a given period of time. It is perhaps the most controversial component of the revenue requirement formula.

A fair and reasonable overall rate of return allows the utility the opportunity to recover those costs prudently incurred by all classes of capital used to finance the rate base during the prospective period in which its rates will be in effect. *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679, 692-93 (1923) (“*Bluefield*”), and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (“*Hope Natural Gas*”) are the seminal cases that present the legal standards applicable to regulators calculating utility rates of return.

In *Bluefield*, the Supreme Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may

be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.¹¹⁶

Twenty years later, in *Hope Natural Gas*, the Supreme Court reiterated:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.¹¹⁷

Restated, the principles generally accepted by state and federal regulators as the appropriate criteria for measuring a fair rate of return are these:

- A utility is entitled to a return similar to that being earned by other enterprises with corresponding risks and uncertainties, but not as high as those earned by highly profitable or speculative ventures;
- A utility is entitled to a return level reasonably sufficient to assure financial soundness;
- A utility is entitled to a return sufficient to maintain and support its credit and raise necessary capital;
- A fair return can change (increase or decrease) along with economic conditions and capital markets.¹¹⁸

The primary area of disagreement in this proceeding is the determination of the

¹¹⁶ *Bluefield*, 262 U.S. at 692-93.

¹¹⁷ *Hope Natural Gas*, 320 U.S. at 603.

¹¹⁸ I&E St. 2, pp. 3-4. See also *Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239 (Pa. Cmwlth. 1975).

appropriate cost of common equity. The Company is claiming the following rate of return:

<u>Type of Capital</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-Term Debt	50.00%	7.00%	3.50%
Common Equity	50.00%	11.00%	5.50%
Total	100.00%		9.00%

I&E maintains that the Company's claimed 11.00% equity is unsupported given that the Company is not providing safe and reliable service as mandated by the Public Utility Code. Therefore, I&E witness Christopher Henkel recommends that no equity return be awarded:¹¹⁹

<u>Type of Capital</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-Term Debt	50.00%	7.00%	3.50%
Common Equity	50.00%	0.00%	0.00%
Total	100.00%		3.50% ¹²⁰

However, if the Commission disagrees with I&E's 0.00% equity recommendation, I&E witness Henkel also conducted a traditional rate of return analysis to address the Company's 11.00% equity claim and recommends the following alternate rate of return for Twin Lakes:

<u>Type of Capital</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-Term Debt	50.00%	7.00%	3.50%
Common Equity	50.00%	9.23%	4.62%
Total	100.00%		8.12% ¹²¹

¹¹⁹ I&E St. No. 2, p. 6.

¹²⁰ I&E Exhibit No. 2, Schedule 1.

¹²¹ I&E Exhibit No. 2, Schedule 1.

Twin Lakes is claiming a 9.00% rate of return based on the year ended September 30, 2019.¹²² However, as I&E's evidence demonstrates, Twin Lakes fails to provide its customers with adequate and reasonable service therefore, I&E believes it to be in the public interest to allow Twin Lakes a 3.50% overall rate of return.

B. Proxy Group

A proxy (or barometer) group is a group of companies that act as a benchmark for determining the utility's rate of return in a base rate case. A proxy group is used as a benchmark to satisfy the long-established guideline of utility regulation that seeks to provide the subject utility with the opportunity to earn a return equal to that of similar risk enterprises.

A proxy group is typically utilized since the use of data exclusively from one company may be less reliable than using data from a group of companies. The lower reliability occurs because the data for one company may be subject to events that can cause short-term anomalies in the marketplace. The rate of return on common equity for a single company could become distorted in these circumstances and would therefore not be representative of similarly situated companies. The use of a proxy group has the effect of smoothing out potential anomalies associated with a single company.

Mr. Henkel selected his proxy group based on the following criteria:

1. 50% or more of the company's revenues must be generated from the regulated water/wastewater utility industry;

¹²² I&E Exhibit No. 2, Schedule 1,

2. The company's stock must be publicly traded;
3. Investment information for the company must be available from more than one source, including Value Line;
4. The company must not be involved in an announced merger or the target of an announced acquisition when I&E conducts its analysis to determine a fair and reasonable rate of return for the subject utility;
and
5. The company must have five consecutive years of historic earnings data.

Mr. Henkel's proxy group comprises of American Water Works, American States Water Co., California Water Service Group, Middlesex Water Co., and York Water Company.¹²³

Twin Lakes conducted no analyses using a proxy group; therefore, no criteria were used by the Company to form a proxy group.

C. Capital Structure

A capital structure should be representative of the industry norm and be an efficient use of capital. The use of a capital structure that is significantly outside the range of the industry's capital structure may result in an overstated overall rate of return.

¹²³ I&E St. No. 2 at 5.

Here, Twin Lakes is claiming a capital structure of 50.00% long-term debt and 50.00% equity.¹²⁴ I&E accepts the Company's capital structure of 50.00% long-term debt and 50.00% equity for the historic test year because its claimed capital structure is appropriate as it falls within the range of the proxy group's capital structure ratios.¹²⁵

D. Cost of Long-Term Debt

I&E witness Henkel does not disagree with Twin Lakes claimed debt cost rate of 7.00%.¹²⁶ The claimed 7.00% cost of debt is the stated interest rate on a \$1,000,000 Promissory Note held by Middlesex Water, Twin Lakes parent company, which is payable upon demand at the option of the holder. This claimed cost of debt exceeds Mr. Henkel's proxy group's debt cost range by 74 basis points; however, the Company has attempted to secure lower-cost debt from PENNVEST but was unsuccessful as its Parent, Middlesex, was unwilling to provide a repayment guarantee in order to establish credit at a lower cost for Twin Lakes. Nevertheless, Twin Lakes should still be encouraged to seek debt at a lower cost rate, including through channels available to the Parent.¹²⁷

E. Return on Common Equity

1. Introduction

I&E's recommendation of a 0.00% cost of common equity is in the public interest, as explained more thoroughly below, because the Company is not meeting its obligation to provide adequate and reasonable service to its customers. The 11.00% return

¹²⁴ Twin Lakes Filing, Schedule F.

¹²⁵ I&E St. No. 2, p. 9.

¹²⁶ I&E St. No. 2, p. 10.

¹²⁷ I&E St. No. 2, p. 11.

recommended by the Company is excessive and unsupported by the facts in evidence. An excessive return on common equity would result in rates that are neither just nor reasonable and should, therefore, be rejected.

As the Pennsylvania Supreme Court noted in interpreting *Hope Natural Gas*:

[w]e do not believe, however, that the *Hope* decision stands for the proposition ... that the end result of a ratemaking body's adjudication must be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility concerned: Rather the *Hope* decision requires only that the regulatory authority balance consumer and investor interests to determine "just and reasonable" rates.¹²⁸

The I&E 0.00% cost of common equity recommendation is just and reasonable when taking into consideration the quality of service and high rates these customers are subjected to. However, I&E witness Henkel's analysis indicates that should the Commission determine Twin Lakes is entitled to a return on equity, his recommendation would be 9.23%. Accordingly, the cost of equity proposed by Twin Lakes should be rejected.

2. I&E's Primary Recommendation

As mentioned previously, it is I&E's primary recommendation that Twin Lakes receive 0.00% return on equity due to its failure to provide adequate and reasonable service.

As a public utility, Twin Lakes, is bound by the requirements of the Public Utility

¹²⁸ *Pennsylvania Electric Company v. Pa. P.U.C.* 502 A.2d 130, 133 (Pa. 1985); *appeal dismissed*. 476 U.S. 1137, 106 S. Ct. 2239, 90 L. Ed. 2d 687 (1986).

Code. One such provision of the Code, 66 Pa. C.S. § 1501, states:

Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary or proper for the accommodation, convenience, and safety of its patrons, employees, and the public. Such service shall be reasonably continuous and without unreasonable interruptions or delay. Such service and facilities shall be in conformity with the regulations and orders of the commission.¹²⁹

The Code places the burden on the public utility to remedy any deficiencies in its system to ensure that its customers receive “adequate, efficient, safe, and reasonable service.” Further, 66 Pa. C.S. § 523(a), requires the Commission to consider the efficiency, effectiveness, and adequacy of service of each utility when determining just and reasonable rates. If service is inadequate, the Commission has the authority to disallow a rate increase under 66 Pa. C.S. § 526(a):

The Commission may reject, in whole or in part, a public utility’s request to increase its rates where the commission concludes, after hearing, that the service rendered by the public utility is inadequate in that it fails to meet quantity or quality for the type of service provided.

I&E believes this proceeding involves extraordinary circumstances in which the Company is not meeting its obligation to provide adequate and reasonable water service to its customers as required by the Code. The following reasons, when considered as a whole, compose the basis of I&E’s 0.00% return on equity for Twin Lakes.

¹²⁹ 66 Pa. C.S. § 1501.

a.) Reliability of Service

Water supply to Twin Lakes' customers remains a major concern of I&E as the Company currently has only one functioning well. As stated previously, Well #1 collapsed and is no longer functioning due to the excessive unaccounted-for water on the Company's system. Twin Lakes has not replaced or repaired Well #1; therefore, Well #2 is the sole source by which customers receive water service.¹³⁰ This is concerning because according to Twin Lakes' witness Fullager, Well #2 is stressed due to over-pumping which increases risk of collapse.¹³¹ Mr. Fullager also indicated that the over-pumping of Well #1 was a contributing factor in its collapse rendering it non-usable.¹³² If Well #2 were to collapse or fail, Twin Lakes' customers will be without water service which poses a severe threat and creates serious concern regarding the Company's ability to provide reasonable and adequate water service to its customers going forward. In rebuttal testimony, Twin Lakes does nothing to quell the fears of I&E and instead, Twin Lakes' witness Fullagar affirms that the only functioning well, Well #2, is constantly stressed by the over-pumping as a result of the excessive leak rate.¹³³ He goes on to state that Well #2 is at an increased risk of collapse.¹³⁴

Despite these very real service concerns, Twin Lakes witness Tilley states, "Twin Lakes has made necessary improvements on an ongoing basis to maintain safe and

¹³⁰ I&E St. No. 3, p. 21.

¹³¹ Twin Lakes Statement No. 3, p. 2.

¹³² Twin Lakes Amended St. No. 3, p. 2.

¹³³ Twin Lakes Statement RKF-R, p. 2.

¹³⁴ Twin Lakes Statement RKF-R, p. 2.

reasonable service.”¹³⁵ Ms. Tilley believes “the owners of Twin Lakes should be both commended and rewarded for their ongoing efforts and related results to improve and maintain the quality of service for the customers of this high risk system.”¹³⁶ The contrary is true because, despite Ms. Tilley’s testimony, the evidence has shown that Twin Lakes has not made the necessary improvements to provide safe and reasonable service to its customers. If Twin Lakes did, in fact, make these necessary improvements such as installing and placing into service a new well, Mr. Fullagar would not have addressed the leak rate and stress on Twin Lakes’ only functioning well. Twin Lakes’ failure to ensure customers have an alternate source of water other than Well #2 disregards its obligation under the Code to provide adequate, efficient, safe, and reasonable service and facilities for its customers.¹³⁷ Twin Lakes’ witness Fullagar, in his rebuttal testimony, essentially puts the Commission on notice that Twin Lakes may be in jeopardy of not providing water to its customers due to its failure to install and place into service another well.

b.) Prior Settlement Agreements

I&E raised its concerns about the Company’s service in two prior rate cases and attempted to resolve those concerns through settlements in both the 2011 and 2015 base rate proceedings. However, the Company failed to adhere to the commitments made in both the 2011 and 2015 Settlements and the reliability of its water service has deteriorated; therefore, no return on equity is warranted in the instant proceeding.

¹³⁵ Twin Lakes Statement MLT-R, p. 9.

¹³⁶ Twin Lakes Statement MLT-R, p. 10.

¹³⁷ 66 Pa. C.S. § 1501.

First, in the 2011 Settlement, at Docket No. R-2011-2246415 (Order entered March 1, 2012), Twin Lakes agreed to reduce its current level of unaccounted-for of 55% by 10% within 18 months from the effective date of rates in that proceeding, or by September 3, 2013. Over the subsequent 48-month period, the Company agreed to reduce the unaccounted-for water levels by 10% each year; however, those levels did not go down to as specified in that agreement.¹³⁸ Rather than decrease, the Company's reported unaccounted-for water was 86.2% in 2013 and 86.6% in 2014, which is not a decrease from the baseline of 55% established in the 2011 Settlement.¹³⁹ The unaccounted-for water problem persists as it has remained consistently high, ranging from 78.7% to 82.9% in 2015-2018, and in no way demonstrates an annual 10% decrease per year as agreed in the 2011 Settlement. This excessive unaccounted-for water is straining the wells and may lead to the collapse Well #2, just as it did with Well #1. Although the Company committed to reducing unaccounted-for water approximately eight years ago, the issue persists unabated today.

Second, in the Company's 2015 rate case settlement, at Docket No. R-2015-2506337, the parties agreed to a total 164.54% increase to be phased in over a three-year period with specific triggering events related to the replacement of Well #1.¹⁴⁰ Specifically, pursuant to the 2015 Settlement, Twin Lakes agreed to replace Well #1 and place the new well into service before the second phase of the rate increase was triggered.

¹³⁸ I&E St. No. 3, pp. 5-6.

¹³⁹ I&E Ex. No. 3, Sch. 3, p. 3.

¹⁴⁰ *Pennsylvania Public Utility Commission v. Twin Lakes Utilities, Inc.*, Docket No. R-2015-2506337, pp. 9-11, 20-22 (Recommended Decision dated April 21, 2016).

To date, Well #1 has not been replaced as contemplated in the 2015 Settlement. Additionally, under the third phase of the rate increase, the Company agreed to the following: install a new supply main to connect to the replacement Well #1 to the distribution system; replace 4,000 feet of main; replace Twin Lakes owned service lines in conjunction with the main installations, and install a new air relief valve; and, after replacement of Well #1, Twin Lakes committed to increase pressure by 1 psi every 2 months during warmer months.¹⁴¹ To date, none of these commitments have been completed. The 2015 Settlement unsuccessfully attempted to address and remedy these service issues by tying system improvements to rate increase phase-ins. Ultimately, Twin Lakes did not complete all system improvements agreed upon in the 2015 Settlement and these issues continue to persist to the detriment of the customers. In particular, Twin Lakes has failed to repair or replace Well #1, install a new supply main to connect a replacement well to the Twin Lakes system and install a new air relief valve, all of which were addressed in the 2015 Settlement. Further, the Settlement required the replacement of 4,000 feet of main, however, according to information received through discovery, 1,210 feet still need replaced.¹⁴²

The improvements Twin Lakes has failed to undertake are crucial and needed to mitigate the problems of unacceptably high levels of Twin Lakes' unaccounted-for water and the stress currently placed on Well #2. Twin Lakes was put on notice in the two previous base rate cases that these major improvements were necessary in order to

¹⁴¹ I&E St. No. 3, pp. 23-24. I&E Ex. No. 3, Sch. 9.

¹⁴² I&E Exhibit No. 2, Schedule 7.

provide adequate service to its customers. Twin Lakes' failure to address these problems demonstrates its disregard of its obligation under the Code and warrants 0.00% equity as recommended by I&E.

c.) Lack of Due Diligence

Twin Lakes appears to assert that it is not fully responsible for the condition of the system because the age and quality of the original pipe materials and poor workmanship related to leak repairs all took place before the current owner acquired the system.¹⁴³ Blaming the prior owner does not relieve the Company of its current service obligations under the Code and rings false given that Middlesex acquired the system approximately a decade ago. Moreover, I&E believes that if Middlesex, the Company's Parent, had performed its due diligence the level of capital expenditures needed to make system improvements would have been evident.¹⁴⁴ First, it should have been readily apparent that Twin Lakes' small customer base of 114 customers severely limits its ability to dilute large capital expenditures. The customer base should have been known to Middlesex prior to taking ownership of Twin Lakes. Second, the fact that capital expenditures would be required was evident when Middlesex acquired Twin Lakes given that the

¹⁴³ Twin Lakes St. RKF-R. p. 2.

¹⁴⁴ I&E St. No. 2. p. 21.

Commission order that approved the sale of Twin Lakes to Middlesex, at Docket No. A-2008-2050092, stated as follows:

The Department of Environmental Protection has indicated the system is very aged, poorly maintained and cannot hold pressure in the distribution lines; the storage tank is very fragile. Between the months of September 2008 and January 2009, there have been many leaks and system breakdowns resulting in water outages and boil water advisories.¹⁴⁵

Certainly, it is reasonable to conclude from the DEP's statements that improvements were needed to the system in order to provide adequate, reliable, safe, and reasonable service to Twin Lakes' customers and, from a timing perspective, all of that was known prior to Middlesex acquiring the Twin Lakes system.

The Company contends that it did not anticipate the investment needed. Middlesex discusses the extraordinary costs required to be incurred to ensure safe and reliable service to Twin Lakes customers in its Application to Abandon Service ("Abandonment Application") that was filed in 2018.¹⁴⁶ In its Abandonment Application, Middlesex indicates that the costs of system improvements needed at Twin Lakes are larger than anticipated.¹⁴⁷ This is surprising given that, as discussed above, it should have been aware that DEP indicated that the system was aged and poorly maintained when Middlesex acquired the system in 2009. Additionally in the Public Input Hearings that

¹⁴⁵ *Joint application of Middlesex Water Company (Middlesex) and Twin Lakes Water Services, LLC (Twin Lakes) for approval of: 1) the transfer by sale of Twin Lakes to Middlesex; 2) the right of Middlesex to begin to offer, render, furnish and supply water service to the public in the development of Sagamore Estates, Shohola Township, Pike County; and 3) the abandonment of public water service by Twin Lakes.* Docket No. A-2008-2050092, p. 5 (Order entered February 26, 2009).

¹⁴⁶ *Twin Lakes Utilities, Inc. Application to Abandon Service to its Customers in Sagamore Estates.* Docket No. A-2018-3005590, p. 4.

¹⁴⁷ *Id.*, p. 3.

occurred in Twin Lakes' 2011 base rate proceeding, Mr. Gregory Paul Hoeper, Shohola Township Supervisor in 2011, testified that Middlesex was aware that the Company it purchased and the facilities it took over were in poor condition when it chose to make the investment in what is now the Twin Lakes system.¹⁴⁸

In rebuttal, Twin Lakes' witness Fullagar explains that Middlesex determined after the acquisition that the pump station lacked a properly functioning master meter.¹⁴⁹ He goes on to state that it was known that individual customers had no meters and that the previous owner had no information available in relation to the well pumps or who last serviced or worked on the well pumps.¹⁵⁰ Accordingly, Mr. Fullagar states it was impossible for Twin Lakes to ascertain with any degree of confidence what the unaccounted-for water rate was at the time of the acquisition.¹⁵¹ However, I&E witness Henkel accurately points out that Mr. Fullagar only further demonstrates the Company's lack of due diligence as a thorough inspection of the system would have revealed the absence of a fully functioning master meter on the well pump.¹⁵² Moreover, Twin Lakes' witness Tilley acknowledged that at the time of acquisition the PA Department of Environmental Protection indicated that the system was very aged, poorly maintained, unable to hold pressure, had a fragile storage tank, and was plagued by leaks, breakdowns, outages and boil water advisories.¹⁵³

¹⁴⁸ *Pennsylvania Public Utility Commission v. Twin Lakes Utilities, Inc.*, Docket No. R-2011-2246415, pp. 5-6 (Recommended Decision dated January 28, 2012).

¹⁴⁹ Twin Lakes St. RFK-R. p. 6.

¹⁵⁰ *Id.*

¹⁵¹ Twin Lakes St. RFK-R. pp. 6-7.

¹⁵² I&E St. No. 2-R. p. 11.

¹⁵³ Twin Lakes St. MLT-R. p. 10.

The evidence is clear and it is fair to assume that Middlesex knew or should have known that Twin Lakes' customer base was small and that improvements would necessitate a considerable rate increase to those customers let alone the improvements needed to maintain safe and adequate service in this particular system. Moreover, a thorough inspection of the Twin Lakes service area would have revealed the poor condition of the system. Middlesex is a sophisticated entity with water industry expertise, the problems they may encounter after acquiring the system at Sagamore Estates should have been foreseeable given its small customer base and aging infrastructure.

d.) Restricted Access to Capital

In its 2018 Abandonment Application, Middlesex asserts that it cannot continue to provide debt underwriting for Twin Lakes in perpetuity because Middlesex is subject to the cross-subsidization policy of the New Jersey Board of Public Utilities ("NJBPU").¹⁵⁴ Middlesex interprets this policy as prohibiting it from providing any type of guarantee of debt repayment for any of Middlesex's wholly-owned subsidiaries in any regulatory jurisdiction, including Twin Lakes.¹⁵⁵ Twin Lakes opines that this limits its access to capital markets used by its Parent. The Parent's financial institutions require a repayment guarantee from Middlesex in order to grant debt capital to Twin Lakes, which is needed to complete system improvements.¹⁵⁶

¹⁵⁴ *Application to Abandon Service to its Customers in Sagamore Estates*, Docket No. A-2018-3005590, pp. 4-5.

¹⁵⁵ *Id.*

¹⁵⁶ I&E St. No. 2, p. 22.

I&E asserts that Middlesex's interpretation of the cross-subsidization policy of the New Jersey Board of Public Utilities is flawed because it is clear that it does not apply to water providers but instead applies to electric and gas industries.¹⁵⁷ This misinterpretation by Middlesex restricts Twin Lakes' access to capital that is needed for vital system improvements because Middlesex's financial institutions require a repayment guarantee from Middlesex in order to grant debt capital to Twin Lakes.¹⁵⁸ Moreover, if Middlesex has access to debt capital at a cost less than 7.00%, the cost of debt to Twin Lakes is inflated. Additionally, this interpretation is contrary to the benefits claimed by Middlesex in 2009 when it sought Commission approval to acquire the system because its President and CEO, Dennis Doll, stated, "The residents will benefit from additional capital investments we will make to improve overall service quality and with our further focus on keeping rates affordable."¹⁵⁹

Twin Lakes' customers are being unfairly burdened by higher rates related to the Company's high cost of debt and a misinterpretation of the NJBPU cross-subsidization policy. It is important to point out that Twin Lakes did not cite to this cross-subsidization policy in its Application to lend support, nor did Twin Lakes respond in rebuttal testimony to Mr. Henkel's position. Instead, Middlesex appeared to use this cross-subsidization policy to its benefit to avoid providing any financial help to its wholly-owned subsidiary in desperate need for system improvements.

¹⁵⁷ I&E Exhibit No. 2-SR, Schedule 2.

¹⁵⁸ I&E St. No. 2-SR, p. 13.

¹⁵⁹ I&E St. No. 2, p. 22; I&E Exhibit No. 2, Schedule 11.

e.) Delay in Applying for PENNVEST Loan

Despite being aware of the ongoing service issues and committing to system upgrades in the 2015 Settlement, the Company waited until August 2019 to apply for a PENNVEST loan¹⁶⁰ to fund system improvements needed to fulfill its obligations under Section 1501.¹⁶¹ I&E finds the delay in applying for PENNVEST financing subsequent to its agreement to perform system rehabilitations in the 2015 Settlement concerning, and the reasons for the delay are still unknown. I&E witness Henkel speculates that the Company may have been reluctant to take on a large obligation for which it had no certainty of rate recovery in subsequent cases due to its small customer base.¹⁶² Regardless of any such reasons, failure to perform due diligence or to secure funding for necessary improvements on the part of the Company and its Parent does not relieve it of the obligation under 66 Pa. C.S. § 1501.¹⁶³ As discussed earlier, Section 1501 requires regulated utilities to furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and the Company shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary and proper for the accommodations, convenience, and safety of its patrons, employees, and the public.

It is unreasonable and unacceptable that the Company waited until August 2019 to apply for a PENNVEST loan to fund system improvements needed to fulfill its

¹⁶⁰ I&E Exhibit No. 2, Schedule 7.

¹⁶¹ I&E St. No. 2, p. 24.

¹⁶² I&E St. No. 2, pp. 23-24.

¹⁶³ I&E St. No. 2, p. 24.

obligations under Section 1501 and were part of its agreement in the 2015 Settlement. The Company was informed that both the OCA and I&E had concerns about the viability of the Twin Lakes system in the 2015 rate proceeding and specifically addressed the improvements in the 2015 Settlement. It is troubling that the Company would allow the system to fall in further disrepair for approximately 4 years and not complete the improvements agreed to in the 2015 Settlement before applying for a PENNVEST loan in August 2019.

f.) Unreasonably High Rates

It is important that consumers pay rates that are commensurate with the level of service received. In this matter, the disparity is clear between Twin Lakes' customers rates and the level of water service received. This is especially concerning given that the Company is requesting that the current average monthly bill for Twin Lakes customers increase from \$94.59/month to \$248.34/month, which totals approximately \$3,000 per year for water service.¹⁶⁴

This level of a rate increase is unreasonably high. The U.S. Environmental Protection Agency ("EPA") states that water/wastewater rates greater than 2 percent of median household income may be difficult for consumer affordability based on data across many federal and state programs.¹⁶⁵ Twin Lakes' service area is within Pike County, Pennsylvania and according to the U.S. Census Bureau, the median household

¹⁶⁴ I&E St. No. 2, p. 25.

¹⁶⁵ United States Environmental Protection Agency. "Guidance: Coordinating CSO Long-term Planning with Water Quality Standards Reviews." pp. 31-32. https://www3.epa.gov/npdes/pubs/wqs_guide_final.pdf. July 2001.

income for residents of Pike County in 2017 was \$63,417.¹⁶⁶ Two percent of \$63,417 is \$1,268.34, which results in a monthly amount of \$105.69. The current average monthly water bill of a Twin Lakes' water customer is \$94.59.¹⁶⁷ This means currently an average Twin Lakes' water customer pays 1.79% of the median annual household income for Pike County residents for water service which is close to the 2% threshold set by the EPA as "difficult for the consumer." However, based on the Company's filing and the proposed increase, the average monthly water bill would increase to \$248.34.¹⁶⁸ This increase, if approved, is 4.70% of the median household income and 135% above the threshold defined by the EPA as difficult for the consumer.¹⁶⁹ Even if only a portion of the Company's proposed increase were to be approved by the Commission, it would move Twin Lakes' customers closer to unaffordability if not making water unaffordable entirely.

Additionally, Twin Lakes customers made it clear that the bills were unaffordable at the two public input hearings were held in the service territory on October 17, 2019. At these hearings, customers testified about Twin Lakes' high water rates, especially since many customers are retirees surviving on a limited, fixed income.¹⁷⁰ Specifically, Ms. Helen Miller testified, "...my feeling is that this price is a hardship as it is, and it will be an increased hardship when the rates go up or if they go up substantially or any

¹⁶⁶ I&E St. No. 2, p. 25.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ I&E St. No. 2, p. 26.

¹⁷⁰ I&E St. No. 2, p. 26.

amount.”¹⁷¹ This sentiment was echoed by Mr. Grzegorz Nieczaj who stated, “this would be devastating for me if this [rate increase] were to go through.”¹⁷² Mr. Nieczaj testified that if the rate increase were to be granted by the Commission he would have to rent or sell his home due to the level of rates.¹⁷³ Ms. Tami DeFrancesco testified, “I do feel that the increase is just unjust and would really be a hardship for many people.” Lastly, Mr. Jeffrey Shatt, testified that his level of service is disproportionate to the amount Twin Lakes’ charges.¹⁷⁴

It is also worthwhile to mention that unreasonably high water bills can harm ratepayers by placing downward pressure on property values.¹⁷⁵ In addition to driving property values down, high water bills make it difficult to rent properties within the Twin Lakes service area. These issues were not overlooked as they were also addressed customers at the public input hearings.¹⁷⁶

In rebuttal, Twin Lakes failed to offer any solutions to mitigate the problem of unreasonably high rates. I&E believes it is not in the public interest to grant a full rate increase when the quality and reliability of service for these customers is in jeopardy. As the record reflects, Twin Lakes has not made substantial improvements to its system to increase the reliability or quality of service these customers deserve. The issues with the Twin Lakes’ system are not novel as they have been raised in previous proceedings, most

¹⁷¹ Public Input Hearing Tr. p. 83, lines 16-18.

¹⁷² Public Input Hearing Tr. p. 101, lines 12-13.

¹⁷³ Public Input Hearing Tr. p. 100, lines 7-8.

¹⁷⁴ Public Input Hearing Tr. p. 86, lines 1-5.

¹⁷⁵ I&E St. No. 2, pp. 26-27.

¹⁷⁶ Public Input Hearing Tr. p. 100, lines 8-11; Tr. p. 95, lines 14-19.

recently the Company's 2015 base rate proceeding. The Company is aware of the small customer base and the impact a rate increase would have on these customers. The Company had since the 2015 Settlement to produce solutions to rate affordability and system improvements but has failed to do so.

g.) Unaccounted-For Water

Unaccounted-for water was previously discussed in the rate base section of I&E's Main Brief concerning the adjustment to purchased power. It is important to point out that based on Commission policy set forth in 52 Pa. Code § 65.20(4) unaccounted-for water must be kept within reasonable amounts. Unaccounted-for water levels above 20% are considered excessive. Twin Lakes reported that its unaccounted-for water between December 31, 2015 to December 31, 2018 averaged 80.5%,¹⁷⁷ which is approximately 300% higher than acceptable levels set forth by the Commission. Excessive unaccounted-for water levels increase expenses incurred by a utility for pumping, treating, and sending out water into its distribution system.¹⁷⁸ Excessive unaccounted-for water decreases the amount of water available to customers, especially during peak demand periods, and diminishes overall quality of service.

Twin Lakes witness Fullagar addressed unaccounted-for water in rebuttal testimony, which recognized that the system has been and continues to be experiencing a high level of unaccounted-for water and argued that the recommendations made by both

¹⁷⁷ I&E Exhibit No. 3, Schedule 3, p. 2.

¹⁷⁸ I&E St. No. 3, p. 4.

I&E and the OCA do nothing to help improve the current situation.¹⁷⁹ Witness Fullagar goes on to state that the recommendations place the operational viability of the system at significant risk of complete failure absent granting of rates.¹⁸⁰

Witness Fullagar's response only further demonstrates the poor state of the system, of which any replacements or repairs would be the burden of the small customer base to shoulder. It is not in the public interest to recover the costs associated with the excessive unaccounted-for water entirely from Twin Lakes' ratepayers as the Company had not taken substantial steps to remediate the issue since the previous base rate case.

h.) Application to Abandon Service

On October 23, 2018, the Company filed an application to abandon service to its customers.¹⁸¹ In its Abandonment Application, the Company explained that it was concerned about its continued ability to operate and maintain its water system because of the constraints of its small customer base, which limits Twin Lakes' ability to dilute the large capital expenditures needed to improve its system.¹⁸² Surprisingly, the Abandonment Application was filed without providing any plan for continued water service to Twin Lakes customers. In short, it sought Commission approval to simply stop service, leaving customers without water.

In this proceeding, Twin Lakes affirmed this ongoing financial concern in discovery responses claiming it continues to have insufficient cash flow to support its on-

¹⁷⁹ Twin Lakes St. RKF-R, p. 2.

¹⁸⁰ Twin Lakes St. RKF-R, p. 2.

¹⁸¹ *Application to Abandon Service to its Customers in Sagamore Estates*, Docket No. A-2018-3005590.

¹⁸² *Id.*, p. 2.

going capital expenditures and operational expenses needed to provide its customers with safe and reliable water service.¹⁸³ The Parent claims it is constrained by the New Jersey Board of Public Utilities with respect to its ability to finance the system improvements needed to make Twin Lakes water distribution system reliable.¹⁸⁴ Further, the Parent stated regardless of the outcome of this base rate case matter, it is Middlesex's intention to cease funding Twin Lakes' working capital requirements, capital project funding and preliminary design and investigation costs.¹⁸⁵

Ultimately, Twin Lakes' Abandonment Application was rejected by the Commission because the Company did not provide evidence of an alternative buyer or receiver and it also failed to provide a process whereby its customers may obtain water service via conversion to an alternative source such as individual wells.¹⁸⁶ However, the fact that Twin Lakes sought Commission approval to abandon its customers without providing any plan or assurances that its customers would continue to receive water service demonstrates its disregard of its ongoing obligation to provide safe and reliable service to its customers. The Company continuously refers to its inability to generate sufficient revenue and disavows any intention of Middlesex to assist with capital needed to improve the system; however, it does not appear to fully appreciate its obligation under Section 1501 to provide safe and reliable service.

¹⁸³ I&E Exhibit No. 2, Schedule 16, pp. 1-2, part E.

¹⁸⁴ I&E Exhibit No. 2, Schedule 10, pp. 4-5.

¹⁸⁵ I&E Exhibit No. 2, Schedule 17.

¹⁸⁶ I&E Exhibit No. 2, Schedule 8, pp. 1-9.

i.) Conclusion

For the reasons articulated above, the facts support approval of I&E's 0.00% equity recommendation. It is well within the Commission's jurisdiction to deny a utility's rate increase if it finds that the utility is providing inadequate service.¹⁸⁷ Here, Twin Lakes' disregard of its obligations under the Code to provide adequate, efficient, safe, and reasonable service warrants approval of I&E's recommendation of 0.00% return on equity.

3. I&E's Alternate Recommendation

a.) I&E's Discounted Cash Flow Analysis

If the Commission declines to approve I&E's recommended 0.00% equity return explained above, I&E also performed a traditional ROE analysis to counter the Company's requested ROE of 11.00%. To arrive at the alternate recommendation for cost of common equity I&E witness Henkel employed the Discounted Cash Flow method ("DCF") and utilized the Capital Asset Pricing Model ("CAPM") as a check to the DCF results.¹⁸⁸ Although there are four generally recognizable methods for determining the cost of equity, the DCF, CAPM, Risk Premium ("RP"), and Comparable Earnings ("CE"), the Commission historically has used the DCF as the primary methodology to

¹⁸⁷ 66 Pa. C.S. § 526(a).

¹⁸⁸ I&E St. No. 2, p. 30.

determine a utility's cost of equity.¹⁸⁹

In sum, the DCF is “the ‘dividend discount model’ of financial theory, which maintains that the value (price) of any security or commodity is the discounted present value of all future cash flows.¹⁹⁰ The DCF model assumes that investors evaluate stocks in the classical economic framework, which maintains that the value of a financial asset is determined by its earning power, or its ability to generate future cash flows.”¹⁹¹

The DCF recognizes the time value of money, is forward-looking, and has widespread regulatory acceptance. Mr. Henkel confirms the reasonableness of her DCF calculation with a comparison to the CAPM results because the Commission has expressed an interest in having results from another methodology as a point of comparison. While the CAPM is also forward-looking, has wide-spread regulatory acceptance, and is based on the concept of risk and return, it and the other methodologies have flaws that should discount their use as primary determinants. Further, the DCF has greater regulatory acceptance than any other methodology.

Based upon his analysis, Mr. Henkel recommends an alternate cost of common equity of 9.23%. Mr. Henkel's analysis uses a spot dividend yield and a 52-week dividend yield, and earnings growth forecasts. Mr. Henkel employs the standard DCF

¹⁸⁹ The Commission has a long history of determining the cost of common equity by primarily by using the DCF method and informed judgment. *See Pa. P.U.C. v. PECO Energy Co.*, 87 Pa. P.U.C. 184, 212 (1997); *Pa. P.U.C. v. City of Bethlehem*, 84 Pa. P.U.C. 275, 304-05 (1995); *Pa. P.U.C. v. Media Borough*, 77 Pa. P.U.C. 446, 481 (1992); *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 71 Pa. P.U.C. 593, 623-32 (1989); *Pa. P.U.C. v. Western Pennsylvania Water Co.*, 67 Pa. P.U.C. 529, 559-70 (1988); *Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division*, 87 Pa. P.U.C. 826 (1997).

¹⁹⁰ I&E St. No. 2, p. 11.

¹⁹¹ I&E St. No. 2, p. 11.

model formula, $k = D_1/P_0 + g$, where k = the cost of equity, D_1 = the dividend expected during the year; P_0 = the current price of the stock; and g = the expected growth rate.¹⁹² When a forecast of D_1 is not available, D_0 (the current dividend) must be adjusted by $\frac{1}{2}$ the expected growth rate¹⁹³ in order to account for changes in the dividend paid in period one.¹⁹⁴ Since forecasts for each company in his proxy group were available from Value Line, no dividends were adjusted for his analysis.

Using his recommended dividend yield of 1.70% and his recommended growth rate of 7.53%, Mr. Henkel calculates an appropriate alternate return on common equity for Twin Lakes to be 9.23%.¹⁹⁵

(i.) Dividend yields

A representative yield must be calculated over a time frame sufficient to avoid short-term anomalies and stale data. Mr. Henkel's dividend yield calculation places equal emphasis on the most recent spot (1.58%) and 52-week average (1.82%) dividend yields resulting in an average dividend yield of 1.70%.¹⁹⁶

(ii.) Growth rates

Mr. Henkel examined the earnings growth forecasts and used five-year projected growth rate estimates from Value Line, Yahoo! Finance, Zacks, and Morningstar. The

¹⁹² I&E St. No. 2, p. 32.

¹⁹³ The adjustment of $\frac{1}{2}$ the growth rate is used when the timing of the dividend increase is not known for certain. It could occur next month, or in the twelfth month. On average, it is safe to assume that the increase will occur half way through the prospective year. Therefore, an adjustment by $\frac{1}{2}$ the expected growth rate is appropriate.

¹⁹⁴ I&E St. No. 2, p. 32.

¹⁹⁵ I&E St. No. 2, p. 34.

¹⁹⁶ I&E St. No. 2, p. 33.

expected growth rates for the five-company proxy group ranged from 2.70% to 10.00% with an overall average of 7.53%.¹⁹⁷

(iii.) Comparison to CAPM

I&E witness Henkel's analysis of a return on equity using the CAPM methodology uses the standard CAPM formula $K = R_f + \beta(R_m - R_f)$, where K = the cost of equity, R_f = the risk-free rate of return; β = beta, which measures the systematic risk of an asset, and R_m = the expected rate of return on the overall stock. The CAPM formula is actually a form of the more general risk premium approach and is based on modern portfolio theory.¹⁹⁸

For his CAPM analysis, Mr. Henkel chose the risk-free rate of return (R_f) from the projected yield on 10-year Treasury Notes as the most stable risk-free measure. With this choice, Mr. Henkel balanced out issues related to use of long-term bonds and short-term T-Bills. For his Beta, Mr. Henkel used the average of the betas from *Value Line*. To arrive at a representative expected return on the overall stock market, Mr. Henkel surveyed Value Line's 1700 Stocks and the S&P 500 Index. The result of this overall stock market return based on Mr. Henkel's forecasted CAPM analysis is 11.46%. This, in turn, yields a cost of equity result of 8.68%.

I&E witness Henkel gave no specific weight to his CAPM results because of his concerns that unlike the DCF, which measures the cost of equity directly by measuring the discounted present value of future cash flows, the CAPM measures the cost of equity

¹⁹⁷ I&E St. No. 2, p. 33.

¹⁹⁸ I&E St. No. 2, p. 35.

indirectly and can be manipulated by the time period used. However, I&E submits that for purposes of providing another point of comparison, the 8.68% equity result confirms the reasonableness of Mr. Henkel's 9.23% return under his DCF calculation.¹⁹⁹

4. Company Recommendation

Twin Lakes witness Tilley recommends a return on equity of 11.00%.²⁰⁰ The Company states that it did not engage an expert to assist with the development of a proposed fair ROE due to costs; therefore, witness Tilley's recommendation is based upon the small size of the Company and the authorized ROE range of 8.02-10.58% for Pennsylvania water utilities as published in the PA PUC Quarterly Earnings Summary Report for the year ended March 31, 2019.²⁰¹

Unlike the full ROE analysis presented by I&E, Twin Lakes recommendation was formed without conducting a DCF or CAPM analysis and used no water utility proxy groups to establish a benchmark of comparable risk, which is a key factor established by the landmark *Bluefield* and *Hope* cases to determine a fair rate of return for a regulated utility.²⁰² Most importantly, Twin Lakes' recommendation of a 11.00% return on equity is unreasonable especially considering the level of service provided by Twin Lakes to its customers.²⁰³ I&E requests that Twin Lakes' unsupported 11.00% cost of equity be rejected.

¹⁹⁹ I&E St. No. 2 pp. 13-14. The presentation of the CAPM analyses is purely for Commission consideration of an alternative means of analyzing financial data. For the reasons fully set forth in Mr. Henkel's direct testimony, I&E supports the DCF as the superior methodology for conducting a rate of return analysis in a utility ratemaking proceeding.

²⁰⁰ Twin Lakes St. No. 2, pp. 6-7.

²⁰¹ Twin Lakes St. No. 2, pp. 6-7.

²⁰² I&E St. No. 2, p. 38.

²⁰³ I&E St. No. 2, p. 38.

F. Overall Rate of Return

Twin Lakes' claimed rate of return of 9.00% is wholly unsupported and out of synch with its efficiency, effectiveness, and adequacy of service. The evidence overwhelmingly demonstrates that Twin Lakes has been and continues to provide poor service at unreasonably high rates, which does not warrant its claimed 11.00% ROE. I&E's proposed overall return of 3.50% should be adopted due to the inadequate and unreasonable service provided to Twin Lakes' customers. However, should the Commission determine that Twin Lakes is providing adequate and reasonable service, I&E's proposed overall rate of return of 8.12% should be adopted in lieu of the Company's claimed 11.00%.

VIII. OTHER ISSUES

A. Quality of Service

1. Reliability

As previously discussed, Twin Lakes system consists of two wells. Well #1 has collapsed and is currently unusable and Well #2 is currently being over-pumped and is also at increased risk of collapse.²⁰⁴ With Well #1 non-functioning, and Well #2 at risk of collapse, continued service to the 114 customers served by Twin Lakes is at major risk.

As explained by OCA witness Fought, the Company sold 8,115 gallons of water per day in 2018, while Well #2 actually pumped 43,837 gallons per day.²⁰⁵ This means

²⁰⁴ I&E St. No. 3, p. 20.

²⁰⁵ OCA St. No. 3, p. 7.

Well #2 pumped approximately 4.5 times more water than necessary to serve customers.²⁰⁶ This is concerning because it places increased stress on Well #2 with no other backup system in place. Should Well #2 collapse, which is possible given the state of the well and the fact that Well #1 has already collapsed, all 114 customers served by Twin Lakes are at risk of losing water service.

As far back as 2008 when Middlesex acquired the Company, service issues with the Twin Lakes system have been apparent.²⁰⁷ The 3-year phase-in of rates in the 2015 rate case was designed to improve service and reliability as the rate increases were predicated on certain system improvements being made. The Company received 50% of the increase in Phase 1 and Phase 2 was to be implemented when Well #1 was replaced and placed into service. Phase 3 was to be implemented when Well #1 was connected to the distribution system, 4,000 feet of main was replaced, certain Twin Lakes owned service lines were replaced, and a new air relief valve was installed. As evidenced by Company witness Fullagar's testimony, it is clear that Well #1 has not been replaced as was required by Phase 2 of the rate increase²⁰⁸ and is currently approximately 20% complete.²⁰⁹ Further, the main connecting Well #1 with the distribution system and the air relief valve installation have not been completed. Further, only 2,790 of the agreed upon 4,000 feet of main have been replaced.²¹⁰

²⁰⁶ *Id.*

²⁰⁷ I&E St. No. 3, p. 21.

²⁰⁸ Twin Lakes St. RKF, p. 1.

²⁰⁹ I&E Exhibit No. 2, Schedule 7.

²¹⁰ I&E St. No. 3, pp. 23-24.

Section 66 Pa. C.S. § 1501 obligates a utility to provide safe and reliable service with no exception. Twin Lakes failure to execute its agreed upon commitments is concerning. The Company relies solely on Well #2 to provide water to its customers. As noted by OCA witness Fought “[f]rom an operations viewpoint, the replacement Well for Well #1 should be completed and connected to the distribution system as soon as possible to prevent a costly emergency if Well #2 becomes destabilized...”²¹¹ Since the conclusion of the 2015 rate case it appears that there have not been many improvements to the Twin Lakes system. Unaccounted-for water levels remain extremely high and the stability of Well #2 appears perilous. Twin Lakes must begin to adhere to its commitments to improve service to these customers.

2. Exceedance of Lead Action Levels

On November 13, 2019, the Pennsylvania Department of Environmental Protection (“DEP”) issued a notice detailing elevated levels of lead found in drinking water tap samples taken from the Twin Lakes’ system. The DEP notice describes serious health effects such as brain and kidney damage, damaged production of red blood cells that carry oxygen to the body, and lowered IQ. Twin Lakes’ exceedance of the lead action levels is concerning and as a result the Company, I&E, and the OCA entered into a Stipulation detailing the events leading up to and the actions taken since the November 13, 2019 notice issued by DEP.²¹²

²¹¹ OCA St. No. 3, p. 4.

²¹² Twin Lakes Stipulation, Appendix B at Docket No. R-2019-3010958.

The Stipulation sets forth actions to be taken by Twin Lakes moving forward to remediate and notify customers of the lead issues. Among other things, the Stipulation outlines reporting requirements Twin Lakes must adhere to going forward, Twin Lakes must inform its customers that it will test for lead levels at an individual's house upon request, and Twin Lakes must provide the November 13, 2019 notice and information regarding available testing to all new customers. All items included in the Stipulation are intended to ensure that Twin Lakes will take the necessary steps to address the issue and inform customers and the statutory advocates of the developments with respect to lead in the system. These reporting requirements are in the public interest because lead service lines present health and safety concerns and 66 Pa. C.S. § 1501 mandates that a public utility provide safe and reasonable service.

B. Affordability of Rates

I&E addressed the affordability of rates above within its recommendation of 0.00% return on equity.

IX. RATE STRUCTURE

A. Scale Back of Rates

Currently all customers served by Twin Lakes are residential customers. The current customer charge is \$60.41 and the usage rate is \$14.60 per thousand gallons.²¹³ Twin Lakes has proposed a customer charge of \$158.61 and a usage rate of \$38.33 per thousand gallons, resulting in an overall percentage increase for water rates of 162.6%.²¹⁴

²¹³ I&E St. No. 3, p. 25.

²¹⁴ *Id.*

As noted above, I&E witness Sakaya recommended that, if less than the full increase is granted, the rates should be reduced proportionally so that each rate receives the same percentage increase.²¹⁵ In the instant proceeding there was no cost of service study presented on which to base the rates. Therefore, utilizing a proportional scale back will ensure that the already high customer charge is not being increased disproportionately more than the usage rate, and is the most reasonable method to determine rates should the Commission grant less than the full increase.

As Twin Lakes never addressed I&E witness Sakaya's rate structure recommendation in its rebuttal testimony,²¹⁶ thereby presumably accepting the recommendation. Accordingly, I&E requests the ALJ recommend and the Commission order a proportional scale back of rates if less than the full increase is granted.

X. CONCLUSION

Twin Lakes has failed to bear its burden of proof with respect to each and every element of its proposed \$211,793 rate increase. The Company's increase must be reduced to reflect the necessary and appropriate adjustments to ensure that rates are just reasonable. For the reasons stated herein, the Bureau of Investigation and Enforcement respectfully requests that Administrative Law Judge Guhl and the Commission adopt its

²¹⁵ I&E St. No. 3, p. 26.

²¹⁶ I&E St. No. 3-SR, p. 14.

expense, rate base and rate of return recommendations in this proceeding, resulting in I&E's proposed increase of \$51,098.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Erika L. McLain".

Erika L. McLain
Prosecutor
PA Attorney ID No. 320526

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, Pennsylvania 17120

Dated: January 7, 2020

Appendix A

Proposed Findings Of Fact

1. On July 23, 2019, Twin Lakes Utilities, Inc. filed Supplement No. 8 to Tariff Water – Pa. P.U.C. No. 4 to become effective September 19, 2019. Twin Lakes Filing.
2. The proposed water tariff contained changes in rates calculated to recover an estimated annual increase in base rate revenues of \$211,793. Twin Lakes Filing, Notice of Proposed Rate Changes.
3. Under the Company’s proposal, the proposed water base rates for an average water customer using 2,500 gallons per month would increase from \$96.91 to \$254.44 or by 162.50%. Twin Lakes Filing, Notice of Proposed Rate Changes.
4. Two public input hearings were held in this proceeding, at which 11 customers testified. Public Input Hearing Tr. pp. 31-109.
5. Many customers testified about high water rates. Public Input Hearing Tr. p. 83 (Miller), Tr. p. 86 (Shatt), Tr. p. 99 (Nieczaj), Tr. p. 106 (DeFrancesco).
6. 52 Pa. Code § 65.20(4) provides: Levels of unaccounted-for water should be kept within reasonable amounts. Levels above 20% have been considered by the Commission to be excessive. I&E St. No. 3, p. 3.
7. Twin Lakes unaccounted-for water levels ranged from 78.7%-82.9% in 2015-2018. I&E St. No. 3, pp. 5-6.
8. Capital expenditures needed to make system improvements should have been captured as a matter of due diligence before Middlesex acquired the system. I&E St. No. 2, p. 21.

9. The Company did not complete system improvements required as part of the settlement at Docket No. R-2015-2506337. I&E St. No. 2, p. 19.
10. The stress on Twin Lakes Well #2 poses a supply risk to Twin Lakes' customers. I&E St. No. 2, p. 19.
11. On November 13, 2019, the Pennsylvania Department of Environmental Protection issued a notice detailing elevated levels of lead found in drinking water tap samples taken from the Twin Lakes' system. I&E St. No. 2, pp. 9-10.
12. The U.S. Environmental Protection Agency renders water/wastewater rates greater than 2 percent of Median Household Income may be difficult for consumer affordability. I&E St. No. 2, p. 24.
13. The current average monthly bill for a Twin Lakes customer is 1.79% of the median household income for Pike County residents. I&E St. No. 2, p. 26.
14. Twin Lakes is not meeting its obligation to provide adequate and reasonable service to its customers as required by Section 1501 of the Public Utility Code. I&E St. No. 2, p. 18.

Appendix B

Proposed Conclusions Of Law

1. Twin Lakes Utilities, Inc. bears the burden of proving its proposed increase is just and reasonable. 66 Pa. C.S. § 315(a).
2. Twin Lakes Utilities, Inc. has not met its burden of proving by a preponderance of the evidence that it provides "adequate, efficient, safe, and reasonable service and facilities" for its water and wastewater systems as required of Section 1501 of the Public Utility Code, 66 Pa. C.S. § 1501.
3. The Rates as submitted by Twin Lakes Utilities, Inc. in Supplement No. 8 to Tariff Water are unreasonable and unjust.
4. Twin Lakes Utilities, Inc. has failed to properly maintain and operate its water system, which constitutes a failure to provide adequate water service. 66 Pa. C.S. § 1501.
5. Twin Lakes Utilities, Inc. is obligated to remedy any deficiencies in its system to ensure that its customers receive "adequate, efficient, safe, and reasonable service." 66 Pa. C.S. § 1501.
6. In exchange for customers paying rates for utility service, Twin Lakes Utilities, Inc. is obligated to provide safe, adequate, and reasonable service. 66 Pa. C.S. § 1501.
7. The Commission has the authority and obligation to deny a rate increase due to inadequate service. 66 Pa. C.S. § 526(a).

Appendix C

Proposed Ordering Paragraphs

It is Ordered:

1. That Twin Lakes Utilities, Inc. shall not place into effect the rates contained in its Tariff Water- Pa. P.U.C. No. 4, the same having been found to be unjust, unreasonable, and therefore unlawful.

Appendix D

I&E's Primary Position:

	Company Claim	I&E Adjustment	I&E Recommended Allowance
O&M Expenses:			
Rate Case Expense	\$57,333	(\$30,871)	\$26,462
Maintenance Supplies	\$9,509	(\$5,010)	\$4,499
Purchased Power	\$10,524	(\$3,004)	\$7,520
Bad Debt Expense	\$19,095	(\$16,033)	\$3,062
Unaccounted for Water (Purchased Power and Chemicals)	\$13,527	(\$6,388)	\$7,139
Amortization Expense	\$0	\$3,572	\$3,572
Total O&M Expense Adjustments		<u>(\$57,734)</u>	
Rate Base Adjustments:			
Cash Working Capital	\$17,175	(\$4,752)	\$12,423
Acquisition Adjustment	\$54,406	(\$18,388)	\$36,018
Total Rate Base Adjustments		<u>(\$23,140)</u>	
Rate of Return			
Debt Cost (50% of capital structure)	7.00%	0.00%	7.00%
Return on Equity (50% of capital structure)	11.00%	11.00%	0.00%
Total Weighted Cost	9.00%	(5.50%)	3.50%
I&E's Recommended Revenue Increase			\$51,098

I&E's Alternative Position:

	Company Claim	I&E Adjustment	I&E Recommended Allowance
O&M Expenses:			
Rate Case Expense	\$57,333	(\$30,871)	\$26,462
Maintenance Supplies	\$9,509	(\$5,010)	\$4,499
Purchased Power	\$10,524	(\$3,004)	\$7,520
Bad Debt Expense	\$19,095	(\$16,033)	\$3,062
Unaccounted for Water (Purchased Power and Chemicals)	\$13,527	(\$6,388)	\$7,139
Amortization Expense	\$0	\$3,572	\$3,572
Total O&M Expense Adjustments		<u>(\$57,734)</u>	
Income Taxes:			
State Income Taxes	\$10,105	(\$4,042)	\$6,063
Federal Income Taxes	\$19,119	(\$19,119)	\$0
Total Income Taxes		<u>(\$23,161)</u>	
Rate Base Adjustments:			
Cash Working Capital	\$17,175	(\$4,752)	\$12,423
Acquisition Adjustment	\$54,406	(\$18,388)	\$36,018
Total Rate Base Adjustments		<u>(\$23,140)</u>	
Rate of Return			
Debt Cost (50% of capital structure)	7.00%	0.00%	7.00%
Return on Equity (50% of capital structure)	11.00%	1.77%	9.23%
Total Weighted Cost	9.00%	(0.88%)	8.12%
I&E's Recommended Revenue Increase			\$111,777

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3010958
	:	
Twin Lakes Utilities, Inc.	:	

CERTIFICATE OF SERVICE


I hereby certify that I am serving the foregoing **Main Brief** dated January 7, 2020, in the manner and upon the persons listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

Served via First Class and Electronic Mail

Honorable Marta Guhl
Pennsylvania Public Utility Commission
Office of Administrative Law Judge
801 Market Street
Room 4063
Philadelphia, PA 19107
mguhl@pa.gov
धारvell@pa.gov

Lauren E. Guerra, Esq.
Christine Maloni Hoover, Esq.
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101-1923
OCATwinLakes2019@paoca.org

John J. Gallagher, Esq.
711 Forrest Road
Harrisburg, PA 17112
jgallagher@jglawpa.com
Counsel for Twin Lakes Utilities, Inc.



Erika L. McLain
Prosecutor
Bureau of Investigation & Enforcement
PA Attorney ID No. 320526